

# BERKELEY JOURNAL OF INTERNATIONAL LAW

---



## ARTICLES

Cross-Border Commercial Contracts and Consideration

*Kevin J. Fandl*

South Africa and the Human Right to Water: Equity, Ecology and the Public Trust Doctrine

*David Takacs*

Trade Law's Responses to the Rise of China

*Wentong Zheng*

The Evolution of Investor-State Arbitration in the Trans-Pacific Partnership Agreement

*Alexander W. Resar*

# BERKELEY JOURNAL OF INTERNATIONAL LAW

---

VOLUME 34

2016

NUMBER 2

---

## ABOUT THE JOURNAL

The *Berkeley Journal of International Law* (BJIL) (ISSN 1085-5718) is edited by students at U.C. Berkeley School of Law. As one of the leading international law journals in the United States, BJIL infuses international legal scholarship and practice with new ideas to address today's most complex legal challenges. BJIL is committed to publishing high-impact pieces from established and newer scholars likely to advance scholarly and policy debates in international and comparative law. As the center of U.C. Berkeley's international law community, BJIL hosts professional and social events with students, academics, and practitioners on pressing international legal issues. The Journal also seeks to sustain and strengthen U.C. Berkeley's international law program and to cultivate critical learning and legal expertise amongst its members.

**Website:** <http://www.berkeleyjournalofinternationallaw.com/>;  
<http://scholarship.law.berkeley.edu/bjil/>

**Journal Blog:** <http://berkeleytravaux.com/>

**Subscriptions:** To receive electronic notifications of future issues, please send an email to [bjil@law.berkeley.edu](mailto:bjil@law.berkeley.edu). To order print copies of the current issue or past issues, contact Journal Publications, The University of California at Berkeley School of Law, University of California, Berkeley, CA 94720. Telephone: (510) 643-6600, Fax: (510) 643-0974, or email [JournalPublications@law.berkeley.edu](mailto:JournalPublications@law.berkeley.edu).

**Indexes:** *The Berkeley Journal of International Law* is indexed in the *Index to Legal Periodicals*, *Browne Digest for Corporate & Securities Lawyers*, *Current Law Index*, *Legal Resource Index*, *LegalTrac*, and *PAIS International in Print*. Selected articles are available on LexisNexis and Westlaw.

**Citation:** Cite as *Berkeley J. Int'l L.*

**Submissions:** The editors of the *Berkeley Journal of International Law* invite the submissions of manuscripts. Manuscripts will be accepted with the understanding that their content is unpublished previously. If any part of a paper has been published previously, or is to be published elsewhere, the author must include this information at the time of the submission. Citations should conform to THE BLUEBOOK: A UNIFORM SYSTEM OF CITATION (20<sup>th</sup> ed.) except where common sense dictates otherwise. Please review our website for additional submissions guidance and send all manuscripts to [bjilsubmissions@law.berkeley.edu](mailto:bjilsubmissions@law.berkeley.edu).

**Sponsorship:** Individuals and organizations interested in sponsoring the *Berkeley Journal of International Law* should contact the Editors-in-Chief at [bjil@law.berkeley.edu](mailto:bjil@law.berkeley.edu).

**Copyright:** Copyright for material published in the Journal is held by the University of California Regents except where otherwise noted.

# BERKELEY JOURNAL OF INTERNATIONAL LAW

---

VOLUME 34

2016

NUMBER 2

---

## CONTENTS

### Articles

CROSS-BORDER COMMERCIAL CONTRACTS AND CONSIDERATION

*Kevin J. Fandl*.....1

SOUTH AFRICA AND THE HUMAN RIGHTS TO WATER: EQUITY, ECOLOGY AND THE PUBLIC TRUST  
DOCTRINE

*David Takacs*.....55

TRADE LAW'S RESPONSES TO THE RISE OF CHINA

*Wentong Zheng*.....109

THE EVOLUTION OF INVESTOR-STATE ARBITRATION IN THE TRANS-PACIFIC PARTNERSHIP AGREEMENT

*Alexander W. Resar*.....159

# BERKELEY JOURNAL OF INTERNATIONAL LAW

---

VOLUME 34

2016

NUMBER 2

---

## BOARD OF EDITORS

### *Editors-in-Chief*

AVERY BROWN  
VICTORIA C. HARGIS

### *Managing Editor*

CASSANDRA WANG

### *Senior Publishing Editor*

MARISSA RHOADES

### *Publishing Editors*

CHARLOTTE CHUN  
MARIBETH HUNSINGER

TAE KIM

MARJON MOMAND  
MENG MENG ZHAO

### *Submissions Editors*

RAY DUER  
GUILHERME DURAES  
BRIAN HALL  
AARON MURPHY

### *Supervising Editors*

LAUREN ASSAF  
SAYA WALLACE

### *Operations Director*

NEELAM MOHAMMED

### *Online Editors*

KELSEY QUIGLEY  
TANIA SWEIS  
AARON VOIT

### *Web Editor*

JANE PENNEBAKER

### *Book Review Editor*

CHRISTOPHER CASEY

### *Senior Articles Editors*

JUAN ARAGON

LILY DOBSON

EMILY SHULMAN

### *Article Editors*

RACHEL BOSLEY  
TARA BRAILEY  
ANDREA ORTEGA  
MARI SAHAKYAN

REMI SALTER  
CHRISTINA SHIN  
OLIVIER SINONCELLI

GINNY SMITH  
NATALIA TCHOUKLEVA  
CHRIS YANDEL

### *Assistant Editors*

EMMANUELLE BERDUGO  
ELLEN CHOI  
RACHEL FLEIG-GOLDSTEIN

HEIDI LIU  
SARAH MIRZA

SEAN PINCKNEY  
WHITNEY TOLAR  
CHELSEA TURNER

*Members*

PETER ANDREWS  
RENATA BARRETO  
NOUR BENGHELLAB  
ALFREDO DIAZ  
MATT GAUTHIER  
NISHA GIRIDHAR  
GRACE GOHLKE

SARAH GODWIN  
CAMILLE VAN HAMME  
SARAH HUNTER  
RENA KAKON  
HANNAH KHALIFEH  
LIZ KING  
JENNA KELIN  
DAVID NAHMIAS

NAM PHAN  
GIULIA RETTAGLIATI  
JESSICA ROSE  
GABRIEL SIMOES  
LOSIF SOROKIN  
USMAN ALI VIRK  
AYN WOODWARD

*Faculty Advisor*

MARCI HOFFMAN  
KATE JASTRAM

# Cross-Border Commercial Contracts and Consideration

Kevin J. Fandl, J.D., Ph.D. \*

## ABSTRACT

Private contracts for the exchange of goods and services are increasingly made across national borders. Firms continue to look for the best suppliers for their inputs or the best markets for their outputs, and as the costs of transport come down, global market access goes up. Yet the most fundamental tool of international business—the contract—may be much less “global” than the business itself. The understanding that a firm has of how a contract is formed and enforced in their home jurisdiction may conflict with that of their partners or customers in foreign jurisdictions, leading to unnecessary litigation. This Article will examine the common law contract requirement of consideration, an element that can make or break a contract. It will compare the requirements for forming a contract in civil and common law jurisdictions and explain how consideration can be overlooked or underemphasized, and what effect this has on the enforcement of commercial contracts. Finally, it will offer practical suggestions for parties to avoid a consideration challenge following execution of their agreement.

## TABLE OF CONTENTS

INTRODUCTION .....	2
I. HISTORICAL DEVELOPMENT OF THE CONCEPT OF CONSIDERATION .....	7
A. <i>Causa and Consideration</i> .....	7
II. THE PRACTICAL EFFECTS OF THE CONSIDERATION DOCTRINE.....	18
III. THE “EXPECTATIONS PROBLEM” OF INTERNATIONAL CONTRACTS	
ACROSS LEGAL SYSTEMS .....	20
A. <i>Creation of a Contract without Express Assent</i> .....	22
B. <i>Contracts with Intent but no Bargained-for-Exchange</i> .....	23
C. <i>Adequacy of the Consideration – How Much is Enough?</i> .....	24

DOI: <http://dx.doi.org/10.15779/Z38R278>

\* Kevin J. Fandl, Ph.D. (George Mason University), J.D./ M.A. (American University), B.A. (Lock Haven University), is an Assistant Professor of Legal Studies and Strategic Global Management at Temple University. He lectures on comparative contract law around the world, highlighting important distinctions such as the one discussed in this Article.

D. <i>Contracts with Illusory Promises</i> .....	25
E. <i>Back to the Future - Past Consideration</i> .....	29
F. <i>Contracts Based Upon Existing Duties</i> .....	32
IV. SALE OF GOODS CONTRACTS .....	33
A. <i>The Uniform Commercial Code</i> .....	33
1. <i>Firm Offers</i> .....	34
2. <i>Missing Terms</i> .....	35
3. <i>Contract Modifications</i> .....	35
B. <i>The Convention on the International Sale of Goods</i> .....	36
1. <i>Revocation of Offers</i> .....	38
2. <i>Contract Modifications</i> .....	39
3. <i>Contract Validity</i> .....	39
V. ATTEMPTED SOLUTIONS TO THE CONSIDERATION PROBLEM .....	45
VI. AVOIDING THE CONSIDERATION PROBLEM IN COMMERCIAL	
CONTRACTS.....	47
A. <i>General Recommendations</i> .....	47
B. <i>The Consideration Clause</i> .....	48
C. <i>Contract Modifications</i> .....	50
CONCLUSION .....	53

## INTRODUCTION

Without the fear of punishment for breaking contracts, men will break them whenever it is immediately advantageous for them to do so.

Thomas Hobbes, 1588-1679

[A contract is] an agreement, upon sufficient consideration, to do or not to do a particular thing.

Sir William Blackstone

Doing business across borders has become easier and more accessible for firms than ever before. A firm can source its supplies, manufacturing, or any host of services to a party across the globe with relative ease and at significant cost savings. And when it does so, it will enter into contracts with other parties at home and abroad.<sup>1</sup> When doing so, a firm may be under the impression that the contracts it forms will be interpreted and enforced in the same manner regardless of where the parties are located. However, this is not the case.<sup>2</sup>

---

1. E. Allan Farnsworth, *The Past of Promise: An Historical Introduction to Contract*, 69 COLUM. L. REV. 576, 580–83 (1969) (tracing the historical development of trade and describing the need to bargain as a central concept in the development of modern society).

2. See Mark B. Wessman, *Should We Fire the Gatekeeper? An Examination of the Doctrine*

The validity and enforceability of a commercial contract depends on a number of factors found in both civil and common law jurisdictions, including intent, offer and acceptance. Yet, in common law jurisdictions alone, the act of bargaining is also a requirement. Parties from civil law jurisdictions, which have no bargaining requirement, are often unaware of this requirement and fail to account for it in their contracts.

The concept of consideration has long been a staple of common law contract theory.<sup>3</sup> The basic tenet is that a contract will be found unenforceable for lack of consideration if the parties have failed to risk anything in their bargain.<sup>4</sup> Risk of loss is what differentiates gratuitous motivation from mutual commitment.<sup>5</sup> Accordingly, agreements to give something of value with no expectation of a return promise or performance will generally fail for lack of consideration in common law jurisdictions.<sup>6</sup> In order to be valid, a contract requires that the parties bargained for the value being exchanged—the promisee, in other words, must make his promise to the promisor principally because of the promise made to him by the promisor.<sup>7</sup>

In the commercial context, common law parties generally provide for consideration explicitly within the terms of the contract. Parties in these jurisdictions are acutely aware that their contracts may be unenforceable if they do not explicitly spell out the nature of the consideration and show that it was properly bargained for.<sup>8</sup> This is often done through a combination of recitals and a consideration clause in the body of the contract, discussed below.

In law schools in the United States, a common law jurisdiction, consideration is taught as the “exchange element” in a contract—that is, the

---

*of Consideration*, 48 U. MIAMI L. REV. 45, 48–49 (1993) (examining assertions that consideration is of little value in modern contracts and finding that it remains an essential element of any enforceable contract today).

3. See, e.g., Ernest G. Lorenzen, *Causa and Consideration in the Law of Contracts*, 28 YALE L.J. 621 (1919) (tracing the history of the consideration requirement to the development of British common law); Val D. Ricks, *The Sophisticated Doctrine of Consideration*, 9 GEO. MASON L. REV. 99, 102 (2000).

4. See, e.g., SAMUEL COMYN, A TREATISE OF THE LAW RELATIVE TO CONTRACTS AND AGREEMENTS 15 (1809) (describing a contract lacking consideration as a naked promise and unenforceable).

5. But see James D. Gordon III, *Consideration and the Commercial-Gift Dichotomy*, 44 VAND. L. REV. 283, 286–87 (1991) (arguing that “commercial promises” should be enforceable regardless of consideration because they “facilitate economic exchange and therefore should be enforceable.”)

6. See Richard A. Posner, *Gratuitous Promises in Law and Economics*, 6 J. LEGAL STUD. 411–12 (1977).

7. See RESTATEMENT (SECOND) OF CONTRACTS § 71(1) (AM. LAW INST. 1981) (“To constitute consideration, a performance or a return promise must be bargained for.”).

8. However, note that reliance is a frequent substitute for consideration and may be used to convert an unenforceable contract into an enforceable quasi-contract. See, e.g., Randy E. Barnett & Mary E. Becker, *Beyond Reliance: Promissory Estoppel, Contract Formalities, and Misrepresentations*, 15 HOFSTRA L. REV. 443 (1987).



benefit received by one party in exchange for the detriment undertaken by the other.<sup>9</sup> A concise example of consideration is the payment of a fee in order to receive a right to use a piece of property to operate a business. The lessor is suffering a detriment by giving up his right to lease his property to someone else or hold it for himself, in exchange for the lessee's detriment of paying his money to the lessor. Each party benefits from the receipt of the value given by the other and each assumes a risk of loss. Assuming proper offer and acceptance took place, the consideration requirement is satisfied and the contract between these two parties is valid and enforceable.

Contracts that lack valid consideration are usually based on either past consideration or illusory consideration. Past consideration refers to a commitment made in exchange for an act or promise previously agreed to. Illusory consideration refers to a promise by a party who never actually commits to any risk of loss in making their promise, making their commitment *illusory*. Neither of these promises would form a valid contract in a common law jurisdiction.

Common law courts are frequently called upon to decide whether a contract should fail for want of consideration.<sup>10</sup> For instance, a promisor may promise a certain good or service to another party in exchange for payment and then, prior to acceptance by the promisee, the promisor may rescind his offer.<sup>11</sup> The promisee will not be able to claim the existence of a contract because no consideration was provided to the promisor that would obligate him to perform his promise. That would not be the case in most civil law jurisdictions, where intent to make an offer accompanied by a legal cause may be enough to create an irrevocable offer and, ultimately, a contract.<sup>12</sup>

---

9. See, e.g., *Elements of a Contract*, U. NEW MEX. JUD. EDUC. CTR., <http://jec.unm.edu/education/online-training/contract-law-tutorial/contract-fundamentals-part-2> (last visited Apr. 6, 2016) ("Something of value was promised in exchange for the specified action or nonaction.").

10. See *Sharlington v. Stratton*, Plow. 308 ("because words are oftentimes spoken by men unadvisedly and without deliberation, the law has provided that a contract by words shall not bind without consideration. And the reason is, because it is by words which pass from men lightly and inconsiderately, but where the agreement is by deed there is more time for deliberation . . . So that there is great deliberation used in the making of deeds, for which reason they are received as a lien final to the party, and are adjudged to bind the party without examining upon what cause or consideration they were made."); see also *Armstrong v. Toler*, 24 U.S. 258, 260–61 (1826) (invalidating a contract based upon illegal consideration); *Aller v. Aller*, 40 N.J.L. 446 (Sup. Ct. 1878) (challenging a contract under seal as a foolproof substitute for consideration and finding that even sealed agreements can be challenged on the basis of fraud); *Greenleaf v. Barker* (1590) 78 Eng. Rep. 449 (K.B.) (invalidating a contract based upon the preexisting duty rule); *Hunt v. Bate* (1568) 73 Eng. Rep. 605 (K.B.) (invalidating a contract based upon past consideration).

11. Note that there are exceptions to this rule, such as offers to sell goods made by merchants in writing. See U.C.C. § 2-205 (AM. LAW INST. 2002).

12. Consider for example the law of Colombia, which requires for validity that a contract be entered into freely by at least two parties with capacity and consent. See CODIGO CIVIL [C.C.] [CIVIL CODE] art. 1495 (Colom.).

Consideration in the common law context is meant to confirm the intent of the parties to bind themselves to an agreement. The assumption is that if there is no consideration, and no substitute for the missing consideration, there are only empty promises with no affirmation of commitment to be bound by the terms of those promises. Stated another way, consideration serves as a practical confirmation of party's intent.<sup>13</sup>

In civil law jurisdictions, which constitute the vast majority of countries, the concept of consideration does not exist. A contract that fails to demonstrate a bargained-for-exchange, often the heart of consideration in a common law jurisdiction, can still be valid in these jurisdictions as long as the intent of the parties is clear and the cause of the contract is legal.<sup>14</sup> This suggests that far more agreements are valid and enforceable in civil law jurisdictions than would be in common law jurisdictions.

On the contrary, common law jurisdictions usually demand evidence of a bargain or some other inducement to enter the contract to make it enforceable. For example, consider a health food advocate who tells a skeptic that she will give her \$500 if the skeptic eats only fresh fruits and vegetables for a month. The skeptic agrees and abides by the promise for several weeks. Just before the end of the month, the advocate dies of a heart attack. Assuming that the advocate intended to give the skeptic the money for eating fresh fruits and vegetables, a court should theoretically enforce this promise, and likely would in a civil law court. In the common law, however, a court may find no contract due to a lack of consideration since the skeptic didn't actually give up anything of value and did not complete the promise.<sup>15</sup>

Yet common law is not as formalistic in the formation of a contract as civil law is.<sup>16</sup> A common law court will recognize the formation of a contract when the parties have completed their bargaining, regardless of the conclusion of any formalities or manifestation of intent.<sup>17</sup> Stated simply, a contract can be formed without explicit intent in common law jurisdictions, whereas intent alone can make or break a contract in civil law jurisdictions.<sup>18</sup> In most civil law

---

13. See Val Ricks, *Assent is Not an Element of Contract Formation*, 61 KAN. L.R. 591 (2013) (arguing that assent to the contract is not a separate and distinct element from consideration).

14. U.C.C. § 2-205 (AM. LAW INST. & UNIF. LAW COMM'N 1977) (listing the elements of a valid contract, which do not include consideration).

15. Note that there may be a claim for reliance here. Reliance, though not actually a legal claim in contract law, may allow a party who reasonably relied on the promise of another to its detriment and where the promisor could have foreseen such reliance, may have a claim for damages accrued from that reliance.

16. See, e.g., Gregory Klass, *Intent to Contract*, 95 VA. L. REV. 1437 (2009) (providing a comprehensive examination of the intent requirement in contracts and distinguishing British from American interpretations of that requirement).

17. See RESTATEMENT (SECOND) OF CONTRACTS § 21 (AM. LAW INST. 1981) ("Neither real nor apparent intention that a promise be legally binding is essential to the formation of a contract.").

18. See, e.g., The Commission of European Contract Law, *Principles of European Contract*

jurisdictions, formalities are required for the formation of certain contracts, such as marriage contracts, mortgages, and gifts.<sup>19</sup> These formalities may include signatures made in front of notary publics, for instance. Without notarization or other written affirmation, many contracts would be invalid in civil law jurisdictions.

Differences in the interpretation of contracts between common law and civil law jurisdictions can be disastrous for firms. A common law-based firm that does business with firms in civil law jurisdictions may be surprised to learn that their promise constitutes an enforceable contract when they assumed it was only gratuitous. Likewise, a firm in a civil law jurisdiction doing business with a common law firm may discover that their draft contract might be enforced by a common law court despite the lack of clearly expressed consent between the parties. In order to avoid these potentially costly surprises, this Article recommends that an aspiring transnational entrepreneur “familiarize herself with the CISG and with the contract law of the foreign country in which she plans on doing business.”<sup>20</sup>

This Article examines the role of consideration in commercial contracts and assess whether international contracting parties need to worry about this requirement when working across civil and common law jurisdictions. The Article begins by presenting a brief historical overview of the development of contract rules in Roman law and how enforcement was uniquely interpreted between England and continental Europe, leading to the current split in contract interpretation that we have today. This Article then discusses the importance of consideration in commercial contracts today and how some firms contort their contracts to ensure compliance with this doctrine. Finally, this Article explains how disputes in interpretation can arise in the context of multinational firm contracts between civil and common law jurisdictions and how to avoid those disputes.

It is important to note at the outset of this Article that the concerns it raises herein apply most directly to the following contract areas:

- Service contracts (employment, construction, consulting, etc.) between parties in both common law and civil law systems;
- Goods contracts between parties in both common law and civil systems where the Convention on the International Sale of Goods (CISG) does not apply; and,
- Goods contracts between parties applying the CISG but enforcing the contract in a common law jurisdiction

---

Law art. 2:101 cmt. B (Ole Lando & Hugh Beale eds., 2000).

19. These are generally known as solemn contracts.

20. Larry A. DiMatteo, *An International Contract Law Formula: The Informality of International Business Transactions Plus the Internationalization of Contract Law Equals Unexpected Contract Liability*, 23 SYRACUSE J. INT'L L. & COM. 67–68 (1997).

Purely domestic contracts in common or civil law jurisdictions would be validated and enforced in accordance with understood domestic principles of contract law, be they common or civil law concepts. As the Article discusses later, the CISG follows local law to assess valid formation, so consideration rules would apply to a CISG contract if it were to be interpreted by a common law court.<sup>21</sup>

The next Section addresses the origins of contract law in the civil and common law contexts. This will help the reader to better understand why different countries use different standards to decide if a contract has been properly formed and why these concerns remain today despite the globalization of business.

## I.

### HISTORICAL DEVELOPMENT OF THE CONCEPT OF CONSIDERATION

#### A. *Causa and Consideration*<sup>22</sup>

Common law contracts developed from merchant rules in the eleventh century, when the Count of Flanders decentralized the court system to allow local tribunals to handle legal matters, including commercial contracts. However, in the earliest common law cases, no action existed to allow for recovery on a breach of contract claim.<sup>23</sup> From this point and through the abandonment of local courts in the late fifteenth century, two principal categories of actions were brought to common law courts to resolve “contract” disputes—debt and covenant.<sup>24</sup> Debt contracts were explicit or implicit agreements to pay a fixed sum to another party. Covenant actions were for breaches of existing promises made under seal. Executory contracts—contracts that have been agreed upon but not yet fully performed—were not enforceable in court at this time. Thus, it was impossible to legally force someone to comply with their contractual obligations not made under seal in this era, even if one party had already performed and the other had not.

In these medieval courts, then, the only way to enforce an executed contract was to prove that a promise was explicitly made to pay a debt to the promisee and to bring a writ of debt to the court.<sup>25</sup> The defendant promisor could then

---

21. The CISG automatically governs contracts between diverse parties with their principal place of business in CISG member states when the contract involves the sale of goods.

22. Note that excerpts from this Section have been reprinted in the author’s book, KEVIN J. FANDL, *INSIDE THE AMERICAN LEGAL MIND* (Routledge, 2015).

23. See George F. Deiser, *The Origin of Assumpsit*, 25 HARV. L. REV. 428, 438 (1912).

24. See Arthur T. Von Mehren, *The French Civil Code and Contract: A Comparative Analysis of Contract Formation and Form*, 15 LA. L. REV. 687, 699–701 (1955).

25. A writ is a “form of action” that was used to initiate a case in medieval England. A writ was initiated with a letter from the King to local authorities addressing a narrow set of circumstances. And although writs were meant to be flexible and applicable to any type of action, in

request a “wager of law,” which allowed him to testify to the court that he did not owe any such debt to the plaintiff. If the defendant produced eleven individuals to swear that they believed him, the case was dismissed.<sup>26</sup> It should be noted that the wager of law defense was never permitted in U.S. courts.<sup>27</sup>

Before establishing the writ of *assumpsit*, discussed below, common law courts took a formulaic approach to resolving cases.<sup>28</sup> A pleading had to meet the specific requirements set forth in the writ to proceed. For this reason, writs were created for hundreds of specific actions, such as separate writs for trespass to cattle and trespass to pigs.<sup>29</sup> Accordingly, since no cause of action existed for breach of covenant yet, parties relied on other writs to plead their cases. The most successful form of action was for trespass.<sup>30</sup>

Trespass arose as a writ out of the Statute of Westminster II in 1285, which allowed the courts to create forms of action and remedies as necessary in each individual instance.<sup>31</sup> Between 1285 and 1348, a number of actions were brought for trespass on the case alleging what might today be considered an action for breach of contract.<sup>32</sup>

At this time in history, parties had great difficulty enforcing informal and executory contracts due to the inability to prove the existence of a contract not made under seal.<sup>33</sup> These agreements were known as *nudum pactum* or naked promises because they lacked any *quid pro quo*, or exchange.<sup>34</sup> In the middle of the fifteenth century, lawyers began utilizing a new cause of action—*assumpsit*.<sup>35</sup> This was a claim made to enforce a contract, written or verbal, not

---

practice they were highly limited and formulaic. See generally Michael J. Sechler, *Supply Versus Demand for Efficient Legal Rules: Evidence from Early English “Contract” Law and the Rise of Assumpsit*, 73 U. PITT. L. REV. 161 (2011).

26. BOUVIER’S LAW DICTIONARY (1856).

27. *Childress v. Emory*, 21 U.S. 642 (1823) (“The wager of law, if it ever had a legal existence in the United States, is now completely abolished.”).

28. See Deiser, *supra* note 23, at 433 (“[I]n its early history classes of actions were of less importance than rigorous adherence to the formula of the class or form of action chosen.”).

29. See *id.*

30. See *id.*

31. See *id.* at 428 (allowing for a flexible and adaptable approach to development of the common law).

32. See *id.* at 431–32 (describing briefly the sixteen “actions on the case” that might serve as precursors to the creation of the writ of *assumpsit*).

33. For instance, in two fourteenth century cases, plaintiffs brought actions under the writ of trespass where today the action would lie clearly within contract law. Both cases involved a seller engaging in a fraudulent sale. However, as these were likely unsealed agreements, trespass was the only available action. Plaintiffs lost in both cases. See Sechler, *supra* note 25.

34. See COMYN, *supra* note 5, at 1–2.

35. See William M. McGovern Jr., *The Enforcement of Informal Contracts in the Later Middle Ages*, 59 CALIF. L.R. 1145, 1151–52 (1971) (discussing a case from 1369 in which the new writ of *assumpsit* first arose in the case of a patient contracting with a doctor for medical services, where those services were incompetently performed. The author notes that while this was the first known use of the writ, it was not regularly used to enforce contracts until at least the following

under seal or recorded (as a debt contract might be). It served as an independent cause of action and could be brought, unlike a writ of debt, in front of a jury where wagers of law were not permitted.

The writ of *assumpsit* was not immediately recognized as a valid contract enforcement action by the medieval courts in England.<sup>36</sup> However, this changed with *Slade's Case* in 1602. In that case, John Slade brought an action in *assumpsit* against Humphrey Morley, claiming that Slade promised to sell and Morley promised to buy a crop of wheat and rye for £16.<sup>37</sup> Morley reneged on the agreement and Slade sued for what we would consider today a breach of contract.<sup>38</sup> The case dragged on for six years until Chief Judge Lord Popham issued a written opinion formally recognizing the *assumpsit* cause of action:

[E]very contract executory importeth in it self an Assumpsit, for when one agreeth to pay money, or to deliver anything, thereby he promiseth to pay, or deliver it; and therefore when one selleth any goods to another, and agreeth to deliver them at a day to come, and the other **in consideration thereof** promiseth to pay so much money to the other (emphasis added).<sup>39</sup>

The first recorded case in which *assumpsit*—meaning to undertake—was pleaded in a trespass action was the famous *Humber Ferry* case.<sup>40</sup> In that case, a ferryman promised to transport a mare across a river.<sup>41</sup> The ferryman overloaded the boat and it sank, causing the mare to drown.<sup>42</sup> The plaintiff, John Bukton, sought to recover for the loss of the mare by bringing an action in covenant.<sup>43</sup> But because a covenant required an agreement made under seal, which Bukton did not have, he resorted to the claim of trespass on the case.<sup>44</sup>

---

century).

36. In the earliest cases referencing *assumpsit*, parties continued to rely on the writ of trespass to bring their claim. *See, e.g.*, *Prince v. Huish* (1391), in *SELECT CASES OF TRESPASS IN THE KING'S COURTS VOL. II*, 1307–99, in 103 *SELDEN SOC'Y* 430–31 (Morris S. Arnold ed., 1987) (using the writ of trespass to enforce an agreement with a cloth dyer who promised to competently dye cloth for the buyer and who did so incompetently); *Rogerstun v. Northcotes* (1366), in *Select Cases of Trespass in the King's Courts Vol. II*, 1307–99, in 103 *SELDEN SOC'Y* 423–24 (Morris S. Arnold ed., 1987) (applying the writ of trespass against a party who undertook to transport wheat by boat but carelessly drove the boat such that the wheat was lost); *Bukton v. Tounesende* (1348) *Y.B.* 22 Ass. 94, pl. 41 (KB) [*"Humber Ferry Case"*] (allowing for the first time in recorded history the use of the writ of trespass in a breach of covenant case. Defendant promised to transport a horse across a river but overloaded the boat such that the horse was killed. The court applied the law of trespass to badly-performed agreement). *See generally* Sechler, *supra* note 26.

37. *Slade v. Morley* (1602) 4 Co. Rep. 92b.

38. *Id.*

39. *Slade v. Morley* (1602) 4 Co. Rep. 92b.

40. *Bukton v. Tounesende* (1348) *Y.B.* 22 Ass. 94, pl. 41 (KB).

41. *Id.*

42. Note that this was an action to recover damages in tort for injury to person and property.

43. *Id.*

44. *See* J.B. Ames, *The History of Assumpsit*, 2 *Harv. L. Rev.* 1–2 (1888).

The legal claim of *assumpsit* quickly overtook the writs of debt and trespass as the primary action brought for breach of contract.<sup>45</sup> This is the standard contract enforcement action that the common law courts still follow today (though it is no longer called *assumpsit*). It was this writ of *assumpsit* that led to the need for the concept of consideration.

[I]n all contracts, either express or implied, there must be something given in exchange, something that is mutual or reciprocal. This thing, which is the price or motive of the contract, we call the consideration: and it must be a lawful thing in itself, or else the contract is void.<sup>46</sup>

*Assumpsit* was largely an action to enforce commercial contracts, which were often informal (*parol*) and executory (not immediately performed).<sup>47</sup> The common law courts were heavily influenced by merchants who had been seeking recourse for breaches of informal executory contracts (contracts not under seal where parties have not yet completed their performance) since the eleventh century, and *assumpsit* provided such recourse.<sup>48</sup> Facilitation of economic arrangements became the motivating factor in enforcing medieval contracts.

Though the sixteenth century English courts were willing to enforce these informal and executory contracts, they and the merchants invoking these actions were aware of the risk of making every agreement between parties a binding contract. Given the fact that the merchants who engaged in these transactions had little opportunity to formalize the agreements in front of a notary, as was required under most civil law systems then under development, the courts chose instead to create a requirement that the parties bargained for their transaction in lieu of the formalities otherwise required.<sup>49</sup> Hence, the creation of consideration came about.

By the middle of the nineteenth century, courts recognized two forms of *assumpsit*—express and implied, as defined below in 1856:

An express *assumpsit* is where one undertakes verbally or in writing, not under seal, or by matter of record, to perform an act, or to pay a sum of money to another.

An implied *assumpsit* is where one has not made any formal promise to do an act or to pay a sum of money to another, but who is presumed from his conduct to have assumed to do what is in point of law just and right. . . it is a rule that he who

---

45. See, e.g., Ricks, *supra* note 4, at 104–06 (“In an *assumpsit* case where both promise and consideration must be alleged, the combination of promise and the requirement of *causa reciproca* means that the promise is given for the consideration, and vice versa.”). See also W.T. Barbour, *The History of Contract in Early English Equity*, 3 L.Q. REV. 173 (discussing the slow development of *assumpsit* as a contract claim rather than a tort claim).

46. COMYN, *supra* note 5, at 8.

47. See, e.g., Roy Kreitner, *The Gift Beyond the Grave: Revisiting the Question of Consideration*, 101 COLUM. L. REV. 1876, 1887 (explaining that in the absence of separate contract law, the writ of *assumpsit* was used to enforce a debt by implying a promise to pay).

48. See, e.g., *id.* at 2.

49. See Von Mehren, *supra* note 25, at 700–02.

desires the antecedent, must abide by the consequent; as, if I receive a loaf of bread or a newspaper daily sent to my house without orders, and I use it without objection, I am presumed to have accepted the terms upon which the person sending it had in contemplation, that I should pay a fair price for it.<sup>50</sup>

Though civil law jurisdictions never adopted consideration, similarities can be drawn between their doctrine of *causa* and the emerging common law doctrine of consideration at the time.<sup>51</sup> Before explaining the similarities and differences between the two substantive legal concepts, it is important to understand the foundational differences between them. Consideration is a judicially created, common law doctrine, and by its nature, “springs from statutes, regulations, and constitutional provisions” unlike in the civil law.<sup>52</sup> In the civil law, what is “law” and what is a “contract” is determined by an exclusive list of legislative materials (e.g., statutes, regulations), and the function of courts and judges is to apply that “law” in a prescribed and technical manner.<sup>53</sup> As stated by authors John Henry Merryman and Rogelio Perez-Perdomo in their book *The Civil Law Tradition*, “[t]o the average judge, lawyer, or law student in [civil law countries], the traditional theory of sources of law represent the basic truth.”<sup>54</sup> Hence, *causa* as a requirement partly applies because it is statutorily required as a complete codification of the “law.”<sup>55</sup>

The loose definition of *causa* in civil law jurisdictions would be party consent and lawful purpose. As an example of the civil law’s statutory requirements, France’s civil code requires “*une cause licite dans l’obligation*.”<sup>56</sup> The provision translates to “a lawful purpose obliged” or the civil law

50. BOUVIER’S LAW DICTIONARY (1856).

51. See e.g., James Gordley, *Louisiana and the Common Law: Le Jour de Gloire, Est-II Passe?*, 24 TUL. EUR. & CIV. L.F. 191 (2009); Lorenzen, *supra* note 4; Caslav Pejovic, *Civil Law and Common Law: Two Different Paths Leading to the Same Goal*, 32 VICTORIA U. WELLINGTON L. REV. 817 (2001).

52. Charles R. Calleros, *Introducing Civil Law Students to Common Law Legal Method Through Contract Law*, 60 J. LEGAL EDUC. 641, 650 (2010-2011).

53. See JOHN HENRY MERRYMAN & ROGELIO PEREZ-PERDOMO, *THE CIVIL LAW TRADITION: AN INTRODUCTION TO THE LEGAL SYSTEMS OF EUROPE AND LATIN AMERICA* 24 (3d ed. 2007).

54. JOHN HENRY MERRYMAN & ROGELIO PEREZ-PERDOMO, *THE CIVIL LAW TRADITION: AN INTRODUCTION TO THE LEGAL SYSTEMS OF EUROPE AND LATIN AMERICA* 25 (3d ed. 2007).

55. Calleros, *supra* note 49, n. 13.

The German scholar Savigny doubted that a code could comprehensively anticipate “every case that may arise,” because “there are positively no limits to the varieties of actual combinations of circumstances.” Frederick Charles von Savigny, *Of the Vocation of Our Age for Legislation and Jurisprudence* 38 (Abraham Hayward transl., The Legal Classics Library 1986). Nonetheless, Savigny cleverly used an example from geometry to describe the technique that judges might use to apply code provision and underlying principle to resolve any dispute; “In every triangle. . . there are certain data, from the relations of which all the rest are necessarily deductible: thus, given two sides and the included angle the while triangle is given. In like manner, every part of our law has points by which the rest may be given: these may be termed the leading axioms.” *Id.* at 38–39.

56. *Id.* at 651 (citing CODE CIVIL [C. CIV.] [CIVIL CODE] art. 1108 (Fr.)).



requirement of *causa*.<sup>57</sup> While the requirement of consideration is often found in common law legislative materials, its definition and application to particular cases is often bound to prior case law. The differences in both the source of law and interpretation of the law are important to keep in mind when analyzing the doctrine of consideration and *causa*.

Some commentators suggest that the basis of a cause requirement in civil law is morality.<sup>58</sup> To prevent parties from being taken advantage of by, for example, agreeing to a usurious contract, the *causa* doctrine steps in to block enforcement of a contract with an illegal purpose.<sup>59</sup> A prime example of this concept is in the adequacy of the value exchanged between the parties. In most civil law jurisdictions, a price that is much more than the value of the object (usually real property) bargained for will be unenforceable. Consider the French Civil Code, which states, “[i]f the price of an immovable object is inadequate by more than seven-twelfths, the seller has the right to demand rescission of the sale.”<sup>60</sup> This concept of “just sale” creates an adequacy requirement that does not exist in the common law. A common law court leaves the price and value decision up to the parties.<sup>61</sup>

---

57. To illustrate a barrier in comparing the two legal systems, the French law is to be interpreted in the strictest sense, whereas the common law incorporates the doctrines of *stare decisis* and precedent to determine the law’s meaning. *Id.* at 642. Meanwhile in the French system the *Cour de Cassation* (the highest court also called the court of last resort of civil obligations) can ignore prior rulings and a lower court can ignore a higher court’s decision. *Id.* Another example can be seen in the Italian Civil Code of 1942 which provides that:

In interpreting the statute, no other meaning can be attributed to it than that made clear by the actual significance of the words according to the connection between them, and by the intention of the legislature.

If a controversy cannot be decided by a precise provision, consideration is given to provisions that regulate similar cases or analogous matters; if the case still remains in doubt, it is decided according to general principles of the legal order of the State.

MERRYMAN, *supra* note 50, at 44. The Code itself provides the interpretive framework, and, similar to many civil law countries, relies heavily on the provision’s language itself and legislative intent. *Id.* If something remains unclear, as a last resort, the court is to refer to the “legal order of the State,” which echoes to the notions of natural law that today’s common law system has drifted far away from. *Id.* at 45. While in practice civil law countries have turned away from natural law and do get influenced by prior judicial decisions, the Code and the dominant judicial theories echo to notions the common law is essentially distinct from. *Id.* at 45–47. The interpretive differences also raise another key difference by inferring that the civil law, being legislation bound, may be slower to change than the common law.

58. See CHANTAL MAC, FUNDAMENTAL RIGHTS IN EUROPEAN CONTRACT LAW 32 (2008); Lorenzen, *supra* note 4, at 633.

59. See Boris Kozolchyk, *Comparative Commercial Law and the NLCIFT Methodology for Economic Development*, 30 ARIZ. J. INT’L & COMP. L. 65–66 (2013).

60. CODE CIVIL [C. CIV.] [CIVIL CODE] art. 109 (Fr.); HENRY P. DEVRIES, NINA M. GASTON, & REGINA B. LOENING, FRENCH LAW 5–18 (1985).

61. See SAMUEL COMYN, THE LAW OF CONTRACTS AND PROMISES UPON VARIOUS SUBJECTS AND WITH PARTICULAR PERSONS AS SETTLED IN THE ACTION OF ASSUMPSIT 16 (1835) (“But if there be any benefit, labour, or prejudice, however trifling, it is deemed a sufficient consideration.”); DiMatteo, *supra* note 21, at 75.

The doctrine of consideration and the legal requirement for *causa* both deal with the formation of lawful contracts. Civil law countries, at least theoretically, view their codifications of law as complete.<sup>62</sup> It follows that the determination as to whether a contract has formed will depend on whether it meets the statutory requirements. As an example of the requirements to form a valid civil law contract, Article 1108 of the French *Code Civil* requires the following:

*Quatre conditions sont essentielles pour la validite d'une convention:*

(Four conditions are essential for the validity of an agreement)

1. Le consentement de la partie qui s'oblige;  
(The consent of the obligated party)
2. Sa capacite de contracter;  
([The obligated party's] capacity to contract)
3. Un objet certain qui forma la matiere de l'engagement;  
(A certain object which formed the subject of the agreement)
4. Une cause licite dans l'obligation.  
(A lawful purpose.)<sup>63</sup>

Contrast these contractual validity requirements with the requirements in a common law jurisdiction, which include mutual assent, offer, acceptance and consideration. While the civil law requirements focus on the consent of the parties and the object of the contract, the common law requirements focus on the bargain between the parties, regardless of the object. Consideration is described as the bargained-for-exchange between the parties and is often explained in terms of mutuality. It pits one party to the contract against the other and requires a bargaining or negotiation process between them. *Causa* is a principle as much as it is a legal requirement for a contract. Its origins stem from the legal theory that a contract required both consent and some cause “that the law would respect.”<sup>64</sup> Historically, the theory behind *causa* can be divided into two legal actions—one for gratuitous contracts and one for onerous contracts.<sup>65</sup> In the gratuitous contract there must be the *causa* of exercising liberality and conferring some benefit on another, and in the onerous contract there must be the *causa* of receiving the equivalent of what one gave up.<sup>66</sup> The Louisiana Civil Code defines *causa* as “the reason whereby a party obligates himself,” hence it is often described as the contractual motive or purpose.<sup>67</sup>

Common law consideration and civil law *causa* do have important differences with respect to the problems these doctrines were created to solve. The common law focus on unenforceable promises is not as important in civil

---

62. MERRYMAN, *supra* note 50, at 33.

63. Calleros, *supra* note 49, at 651 (citing CODE CIVIL [C. CIV.] [CIVIL CODE] art. 1108 (Fr.)) (translation done by Google); *see also*, RAYMOND YOUNGS, ENGLISH, FRENCH & GERMAN COMPARATIVE LAW 545 (2014).

64. Gordley, *supra* note 48, at 192.

65. *See id.*

66. *See id.*

67. *See* Julian Hermida, *Convergence of Civil Law and Common Law Contracts in the Space Field*, 34 H.K. L.J. 339, 354 (2004).

law.<sup>68</sup> Instead, consent takes on an important role in determining whether a contract exists in civil law jurisdictions, as illustrated by its position as the first requirement in the French *Code Civil* cited above.<sup>69</sup>

However, civil law contracts based upon French law do create more uncertainty about what would be considered a lawful contract through their doctrine of *causa*.<sup>70</sup> As part of the contract formation process, the civil code requires that the contract maintain a lawful object and purpose, though this lawful purpose is not clearly defined by statute, making conclusive determinations challenging.<sup>71</sup>

The doctrine of consideration, though mentioned as early as 1602 in *Slade's Case*, was used interchangeably with the civil law doctrine of *causa* in prior English court decisions. In fact, Lord Mansfield attempted to eliminate the distinct use of consideration as a requirement for a valid contract in an opinion issued in 1765. He wrote, "I take it, that the ancient notion about the want of consideration was for the sake of evidence only; for when it is reduced into writing, as in covenants, specialties, bonds, etc., there was no objection to the want of consideration."<sup>72</sup> He went on to conclude, "[i]n commercial cases amongst merchants, the want of consideration is not an objection."<sup>73</sup>

However, Lord Mansfield's dismissal of consideration was short-lived. The need for consideration in contracts was reaffirmed ten years later in the case of *Rann v. Hughes*.<sup>74</sup> In that case, the court held that "every man is by the law of nature bound to fulfill his engagements. It is equally true that the law of [England] supplies no means, nor affords any remedy, to compel the performance of an agreement made without sufficient consideration."<sup>75</sup>

The doctrine of consideration was clarified in subsequent cases in England and the British colonies, including the United States. Today, we can identify the following characteristics of consideration:

1. A document not under seal requires consideration.
2. Consideration requires a benefit to the promisor or a detriment to the promisee.
3. Moral consideration is insufficient.

---

68. See *id.* at 349.

69. See *id.*

70. See, e.g., J. FLOUR & J.L. AUBERT, *LES OBLIGATIONS: L'ACTE JURIDIQUE* (5th ed. 1991) (finding *causa* to be "one of the most uncertain ideas of civil law.").

71. See YOUNGS, *supra* note 59, at 546; see also CODE CIVIL [C. CIV.] [CIVIL CODE] art. 1131 (Fr.).

72. *Pillans v. Van Mierop* (1765) 3 Burr. 1663, 97 Eng. Rep. 1035, 1038 (KB) (quoting from Lord Mansfield).

73. *Id. Contra COMYN*, *supra* note 5, at 13. (suggesting that Lord Mansfield's comment in the *Pillans* case referred only to cases of bills in the hands of the endorsee and not to general informal contracts).

74. *Rann v. Hughes* (1778) 7 T.R. 350n, 101 Eng. Rep. 1014.

75. *Id.*

4. The consideration must be induced by the promise.
5. The adequacy (amount) of the consideration is irrelevant, unless fraudulent or sham consideration.<sup>76</sup>

Courts have, in some limited instances, recognized moral obligations as valid consideration. In the 1782 case of *Hawkes v. Saunders*, Lord Mansfield found moral consideration to be sufficient to enforce a variety of promises, including the promise to pay a debt discharged by bankruptcy or barred by the statute of limitations, for instance.<sup>77</sup> However, this approach was rejected by British courts in later cases, such as *Eastwood v. Kenyon*, where a promise to pay a debt absent consideration was found to be unenforceable.<sup>78</sup>

Today, moral obligations are not valid consideration in most cases within common law courts. In the United States courts have carved out a small cadre of exceptions, including an adult's promise to pay the debt of a minor,<sup>79</sup> the promise to pay a debt that has been discharged due to bankruptcy or barred by the statute of limitations,<sup>80</sup> and a promise in which the promisor receives a material benefit and promises to pay out of moral obligation.<sup>81</sup> In most other cases, moral obligations are unenforceable in common law courts.

Despite the argument that *causa* cannot be compared to consideration due to structural and doctrinal differences between the two systems,<sup>82</sup> scholars continue to analogize the two.<sup>83</sup> Arguably, the reasoning for the analogy stems from the fact that the requirement of consideration in common law jurisdictions prevents the enforcement of gratuitous promises or contracts with third-party beneficiaries, whereas a civil law jurisdiction will allow a legal *causa* to support such gratuitous promises and agreements with third-party beneficiaries.<sup>84</sup> With this in mind, both doctrines can be seen as an attempt to draw a line between enforceable and unenforceable contracts, with *causa* drawing more of a theoretical rule as opposed to a hard, practical rule like bargained-for-exchange.<sup>85</sup>

One scholar's explanation for this distinction refers back to the underlying premise of consent in civil law contracts and "the moral principle that contracts

---

76. See Lorenzen, *supra* note 4, at 622–23 (note that the benefit/detriment theory of consideration listed here has largely been replaced with the bargain theory, which requires that the parties have entered the agreement on the inducement of the other's promise).

77. *Hawkes v. Saunders* (1782) 1 Cowp. 289 (KB).

78. *Eastwood v. Kenyon* (1782) 11 Ad. & E. 438, 452–53 (QB).

79. *Mills v. Wyman*, 20 Mass. (3 Pick.) 207 (1825).

80. *Zabella v. Pakel*, 242 F.2d 452 (7th Cir. 1957).

81. *Webb v. McGowin*, 27 Ala. App. 82, 86 (1935).

82. Charles Calleros, *Cause, Consideration, Promissory Estoppel, and Promises under Deed: What our Students Should Know about Enforcement of Promises in a Historical and International Context*, 13 CHI.-KENT J. INT'L & COMP. L. 83, 90–92 (2013).

83. See, e.g., Gordley, *supra* note 48, at 193; Pejovic, *supra* note 48, at 821–22.

84. See Pejovic, *supra* note 48, at 822.

85. See Calleros, *supra* note 49, at 651.

should be observed,” contrasted with a “medieval system of common law writs that began with a decidedly restrictive view of enforceable obligations.”<sup>86</sup> Julian Hermida argues that this underlying distinction would make the two concepts incomparable and that each doctrine is trying to solve its own problem.<sup>87</sup> And though both doctrines set boundaries on the types of contracts that will be enforced, Hermida argues that *causa* “aims at reflecting Aristotle’s distinction between liberality and commutative justice,” while consideration is “merely concerned about limiting in practice the promises that could be enforced.”<sup>88</sup>

Whether the doctrines are comparable or too distinct, the underlying analogy behind the comparison is that both doctrines attempt to provide the “reason that justifies the assumed obligation.”<sup>89</sup> Going further, one might argue that the “reason” is not necessarily *causa* or the contract’s motive but consent in civil law and getting the benefit of the bargain in common law. The earliest of comparative scholars noted that the idea of *causa* was hard to describe as one particular thing as it applied in many different contexts. Perhaps due to its theoretical nature, early U.S. scholars deemed *causa* as “serv[ing] no proper object” because of its lack of a definite and precise meaning.<sup>90</sup>

Unlike the common law, the civil law places special emphasis on the categorization and classification of contracts.<sup>91</sup> The civil law code that dictates which contracts will be enforced is often divided into the “general law of contracts” (*lex generalis*) and the special law of individual contract (*lex specialis*).<sup>92</sup> Consider, for example, contract law in Colombia, a civil law jurisdiction. They divide contracts into three categories: 1) consensual contracts, which require only consent and legal purpose to be valid; 2) solemn contracts, which require notarization to be valid, and; 3) real contracts, which require the delivery of the object to be valid. For a contract to be valid, it must fall within one of these three categories.<sup>93</sup>

Further, civil law legal scholars (who are seen as “dominant actors of the civil law”)<sup>94</sup> have divided contracts into more refined categories such as “nominated and innominate, consensual and real, bilateral and unilateral, and

---

86. *Id.* at 653 (describing the concept as cause/causa as “expansive” and reflecting the “Napoleonic Code Civil’s respect for the autonomy of the parties”).

87. See Hermida, *supra* note 63, at 354–55.

88. *Id.* at 355.

89. *Id.* at 354.

90. Lorenzen, *supra* note 4, at 646 (“There is in reality no definable ‘doctrine’ of causa. The term ‘causa’ includes a variety of notions which may equally well be derived from the nature of a juristic act and from considerations of equity.”) (notably framed in terms of “law” and “equity”).

91. Hermida, *supra* note 63, at 345.

92. *Id.*

93. See, e.g., <http://www.abogadosbogota.info/requisitos-de-validez-de-los-contratos> (describing the legal requirements to form a valid contract in Colombia).

94. MERRYMAN, *supra* note 50, at 60.

commutative and aleatory, among others.”<sup>95</sup> Each type is said to have its own “legal nature.”<sup>96</sup> Some of the categories are familiar in common law systems, but their definitions are different. In contrast, the common law has established formation principles that apply to all contracts with equitable exceptions.

Additionally, formalities, such as a writing or certification by a notary (equivalent to a lawyer in most civil law countries) remain part of the civil code requirements in many parts of Latin America, including in the Chilean civil code.<sup>97</sup> Writing requirements are also found for certain types of contracts in the French and German civil codes,<sup>98</sup> which would also be unenforceable under the parol evidence rule in common law which requires certain oral contracts to be evidenced by a writing to be enforceable. The rationale for requiring a writing in civil law systems is to uncover the true intent of the parties outside of the contract terms alone and “to stamp out the courts’ reliance on fraudulent testimonies purchased by the parties or their attorneys from ‘witnesses’ who offered their ‘testimony’ to the highest bidder literally steps away from the courtroom where judges and their clerks adjudicated contractual intent.”<sup>99</sup>

The common law appears more concerned with distinction as opposed to classification, as seen in the courts of law versus equity and the contract versus the quasi-contract (e.g., promissory estoppel/reliance).<sup>100</sup> There are challenges in trying to compare one system to the other. Saying that consideration is not required in civil law countries is true but misleading. The relevant code will dictate what is required for contract validity in the civil law country. Determining whether a contract has a *causa* might force the lawyer to classify the contract at hand.<sup>101</sup> If the contract is bilateral or onerous then *causa* takes the form of “receiving the equivalent of what one gave up,” which, semantics aside, is very similar to the bargained-for-exchange definition of consideration.<sup>102</sup> The similarities and distinctions of the two systems may go on *ad infinitum* as the two continue to change over time. Understanding which contracts are valid and legally enforceable requires a lawyer to understand the most important similarities and differences not just between contract laws, but also the legal systems as a whole.

---

95. Hermida, *supra* note 63, at 346. See also Farnsworth, *supra* note 2, at 589–90 (explaining the shortcomings of contracts that require execution to prove their existence).

96. *Id.*

97. Kozolchik, *supra* note 55, at 68.

98. These include non-commercial financial obligations exceeding a minimum amount, mortgages, and marriage contracts, among other things. See Arthur T. Von Mehren, *Civil-Law Analogues to Consideration: An Exercise in Comparative Analysis*, 72 HARV. L. REV. 1009, 1019–20.

99. Kozolchik, *supra* note 55, at 69.

100. This is opinion only.

101. *Causa* will likely be presumed and it is up to the party disputing the contract to prove its non-existence. See Hermida, *supra* note 63, at 355.

102. See, e.g., *id.*; see also Gordley, *supra* note 48, at 192, 205.

Is the common law approach workable for commercial contracts? Though the civil law approach codified in the nineteenth century is clear and enforces a broader array of contracts than the common law, the civil system is rigid and difficult to change in light of the creation of new forms of contracts (e.g., online contracts, franchise agreements, shrink wrap agreements). The common law, on the other hand, is flexible and constantly evolving to meet the changing nature of contracting between parties.

In the common law, “[e]very new case is an experiment. . . The principles themselves are continually retested; for if the rules derived from a principle do not work well, the principle itself must ultimately be reexamined.”<sup>103</sup> And “consideration [is] the way to isolate. . . promises worthy of enforcement.”<sup>104</sup> The next Section examines the application of consideration in common law jurisdictions.

## II.

### THE PRACTICAL EFFECTS OF THE CONSIDERATION DOCTRINE

As we can now see clearly, the element of consideration is essential in common law contracts, but not necessarily in civil law contracts. In fact, since the mid-1970s, missing consideration in a common law contract has led to enforcement challenges in over 300 cases.<sup>105</sup> What does this mean for parties engaged in business transactions that cross common and civil law jurisdictions? To better understand the relevance of this concern, it may be helpful to examine some seminal common law cases that hinged on the consideration element of the contract. Though these were purely domestic in nature, they highlight the use of consideration as a validating principle in common law jurisdictions.

In 1869, William Story offered his fifteen-year-old nephew \$5,000 if he would refrain from drinking, using tobacco, swearing or gambling until he turned twenty-one years old.<sup>106</sup> His nephew agreed and complied with his promise by refraining from those activities for six years.<sup>107</sup> On his twenty-first birthday, the nephew informed his uncle of his compliance with the agreement and requested payment.<sup>108</sup> Story responded that his promise was good and that he would pay his nephew when he believed his nephew was ready to have that much money.<sup>109</sup> Before the money was delivered to his nephew, Story died.<sup>110</sup> Story’s nephew had already committed the \$5,000 to his wife and subsequently

---

103. MUNROE SMITH, JURISPRUDENCE 21 (1909).

104. Kreitner, *supra* note 44, at 1897.

105. Wessman, *supra* note 3, at 48.

106. Hamer v. Sidway, 124 N.Y. 538, 544–545 (1891).

107. *Id.* at 549.

108. *Id.*

109. *Id.* The value of \$5,000 in 1875 would be approximately \$125,000 in 2012.

110. *Id.*

to Louisa Hamer, who brought this action against the executor of Story's estate, Mr. Sidway.<sup>111</sup>

The *Hamer v. Sidway* case dealt squarely with the concept of consideration in validating an agreement. If, in this case, Story wished to give a gift to his nephew, he could do so by promising to give the gift, delivering the gift, and having the nephew accept the gift. No consideration would be required—that is, the nephew would not have to do anything other than accept the gift. In a civil law jurisdiction, regardless of the lack of consideration, a gift like this would generally form an enforceable contract.

However, in common law jurisdictions, a promise to give a gift is not a contract. Thus, if the promisor fails to deliver the gift before his death, the promise expires and is treated as an unenforceable (undelivered) gift. In this case, Sidway argued just that—that the promise to pay \$5,000 was merely a gift and, since the money was never delivered to the nephew, the promise was invalidated upon Story's death.<sup>112</sup>

Hamer, on the other hand, argued that the nephew's abandonment of his rights to drink, use tobacco, swear and gamble, provided sufficient consideration to turn this promise from a gift into an enforceable contract.<sup>113</sup> The court agreed. In a widely cited opinion, Judge Alton Parker of the New York Court of Appeals, citing an 1880 treatise, held that:

Courts "will not ask whether the thing which forms the consideration does in fact benefit the promisor or a third party, or is of any substantial value to anyone. It is enough that something is promised, done, forbore or suffered by the party to whom the promise is made as consideration for the promise made to him."<sup>114</sup>

This *benefit-detriment* approach to consideration governed until the early twentieth century, when courts began to apply the "bargain" theory to their analysis of consideration.<sup>115</sup> Rather than evaluating only whether the parties received a benefit and suffered a detriment, the bargain theory allows courts to consider whether the parties made their promises because they were induced by the promise made by the other. At the end of the nineteenth century, Justice Holmes said, "[i]t is hard to see the propriety of erecting any detriment which an instrument may disclose or provide for, into a consideration, unless the parties have dealt with it on that footing."<sup>116</sup> Clarifying, Just Holmes said, "[i]t is not enough that the promise induces the detriment or that the detriment induces the promise, if the other half is wanting."<sup>117</sup> In other words, one-sided consideration

---

111. *Id.*

112. *Id.* at 547-548.

113. *Id.* at 546.

114. WILLIAM REYNELL ANSON, *PRINCIPLES OF THE LAW OF CONTRACT* 63 (1880).

115. See Kevin M. Teeven, *The Advent of Recovery of Market Transactions in the Absence of a Bargain*, 39 AM. BUS. L.J. 289, 292-93 (2002).

116. OLIVER WENDELL HOLMES, *THE COMMON LAW* 292 (1881).

117. *Wisconsin and Michigan Railway Co. v. Powers*, 191 U.S. 379, 386 (1903).



is insufficient to form a valid contract—rather, mutually bargained-for consideration is essential to make a contract enforceable.<sup>118</sup>

The bargain theory helps courts overcome concern over the use of “peppercorn” contracts, that is, contracts that would be gifts but for the exchange of nominal consideration meant to establish a valid and enforceable contract.<sup>119</sup> Thus, if Sam offers to give his car to Rebecca for \$1, the benefit-detriment theory would find the exchange to be a valid and enforceable contract and the \$1 would be treated as sufficient consideration.<sup>120</sup> But the bargain theory would require the court to look further and determine if the \$1 were actually bargained for between the parties—that is, whether the reason Sam is giving the car to Rebecca is *because* she is giving him \$1 and not because Sam simply wants to donate the car to her. These types of contracts are not enforceable today.<sup>121</sup>

### III.

#### THE “EXPECTATIONS PROBLEM” OF INTERNATIONAL CONTRACTS ACROSS LEGAL SYSTEMS

Generally speaking, a contract that is found to have sufficient consideration in a common law jurisdiction will also be found to have sufficient *causa* in a civil law jurisdiction, so long as it is licit. The existence of a bargained-for-exchange is also proof of party intent. Enforceability of such a contract should not pose a problem for the parties in either jurisdiction. The more problematic contracts are those that appear to be enforceable in civil law jurisdictions but that lack sufficient consideration to enforce in common law jurisdictions.

---

118. See Teeven, *supra* note 108, at 294–95.

119. Note that the first Restatement of Contracts permitted such nominal contracts to be enforced:

A wishes to make a binding promise to his son B to convey to B Blackacre, which is worth \$5000. Being advised that a gratuitous promise is not binding, A writes to B an offer to sell Blackacre for \$1. B accepts. B’s promise to pay \$1 is sufficient consideration. Restatement of Contracts § 84, illustration 1 (1932).

However, the second Restatement of Contracts rejected this position:

A desires to make a binding promise to give \$1000 to his son B. Being advised that a gratuitous promise is not binding, A offers to buy from B for \$1000 a book worth less than \$1. B accepts the offer knowing that the purchase of the book is a mere pretense. There is no consideration for A’s promise to pay \$1000. Restatement (Second) of Contracts § 75, illustration 5 (1965).

120. See generally Edmund Polubinski Jr., *The Peppercorn Theory and the Restatement of Contracts*, 10 WM. & MARY L. REV. 201, 202 (1968); No Author, *Restatement of Contracts (Second)—A Rejection of Nominal Consideration?*, 1 VAL. U. L. REV. 102 (1966) (discussing the evolution of the consideration doctrine in the common law and finding that the reason a party enters a contract is critical in determining whether consideration exists).

121. See RESTATEMENT (SECOND) OF CONTRACTS § 79 (AM. LAW INST. 1979); see also Joseph Siprut, *Comments: The Peppercorn Reconsidered: Why a Promise to Sell Blackacre for Nominal Consideration is not Binding, but Should be*, 97 N.W. U. L. REV. 1809, 1823–24 (2003).

Below are three types of contracts that, while likely enforceable in a civil law jurisdiction, would generally fail in a common law jurisdiction for lack of valid consideration:

*Option contracts.* In the common law, an option to enter a contract at a future date that is not accompanied by consideration fails unless the option is exercised before revocation of that offer.<sup>122</sup> This is not the case in most civil law jurisdictions, where an offer to hold a contract open for a period of time is generally irrevocable.<sup>123</sup> This is the case in the CISG, which follows many civil law principles as well as under the French civil code, which would find the agreement between the parties to be sufficient to form a binding contract.<sup>124</sup>

*Unilateral contracts.* Similar to option contracts, a unilateral offer under common law does not become a binding contract until the performance requested by the offeror has been fully performed.<sup>125</sup> Under the French civil code, agreement to perform by the offeree is sufficient to form a binding contract; however, the offeree must complete the performance within a reasonable period of time or no enforceable contract forms.<sup>126</sup> The only exception to this rule in the United States would be in the event that the offeree substantially performed the unilateral offer, which would make the offer irrevocable for a reasonable period of time.

*Gift contracts.* A gratuitous offer to a donee where no consideration is given to the donor will not form an enforceable contract under the common law.<sup>127</sup> Though such agreements were previously held valid if made under seal, the formality is no longer used and only valid consideration will make the gift binding. In some jurisdictions, nominal consideration (e.g., a peppercorn) will turn a gratuitous offer into a binding contract; however, many jurisdictions consider this sham consideration and will not enforce such agreements. The French civil code allows such promises to be enforceable if made in the presence of a notary.<sup>128</sup>

*Contracts premised on past performance as consideration.* Likewise, a gift cannot be turned into a valid contract by a subsequent promise from the donee. This leads to the problem of past consideration, which is insufficient to support a

---

122. See Arthur Corbin, *Option Contracts*, 23 YALE L.J. 641, 643–44 (1914).

123. See *Chastan v. Isler*, C. Civ. Dec. 17 1958 (Fr.) (finding an offer to sell a chalet in which the offeree expressly committed to inspect the chalet on a future date irrevocable prior to the passing of that date, thereby creating an implied option contract).

124. Von Mehren, *supra* note 25, at 690–91.

125. See I. Maurice Wormser, *The True Conception of Unilateral Contracts*, 26 YALE L.J. 136, 136–37 (1916) (creating the hypothetical “Brooklyn Bridge” case in which A promises to pay B \$100 if B walks across the Brooklyn Bridge. A revokes when B is halfway across, exercising his right under a unilateral contract to cancel prior to complete performance).

126. *Id.* at 692.

127. See George S. Geis, *Gift Promises and the Edge of Contract Law*, 2014 U. ILL. L. REV. 663, 665 (2014).

128. *Id.* at 697–98.

valid contract. For example, if Peter promises (verbally or in writing) to give Paul a sum of money to compensate him for a completed act, that agreement would not be enforceable in common law courts, but it would be enforceable in most civil law courts. Likewise, if a firm were to hire an unpaid intern, who provided invaluable service to the firm that the managers later felt merited compensation, the firm's subsequent promise to compensate that intern for those services would be unenforceable for want of consideration.

The French Civil Code recognizes the creation of a contract when the parties reach agreement on the terms. Lack of consideration is not a barrier to the formation of most contracts, though some formalities may be required for certain types of contracts (e.g., real property transfers).<sup>129</sup>

In addition to the risk that a contract will fail for lack of consideration in common law jurisdictions, a second (and perhaps more dangerous) concern is the ability in common law jurisdictions to form a contract without express assent. Express assent is one of the requirements to form a civil law contract; however, common law courts have been willing to find assent even in the absence of any clear evidence or formalities evidencing such assent. The next series of Sub-Sections address this and similar problems of contract formation in the common law due to the requirement of consideration.

#### A. *Creation of a Contract without Express Assent*

In common law jurisdictions, courts have found a valid contract even where one of the parties did not believe they had explicitly assented to the formation of such a contract. In civil law jurisdictions, parties must agree on the terms before a contract can be formed. Accordingly, a party accustomed to civil law rules entering a contract that would be enforceable under common law rules may find that they are bound prior to their explicit agreement.

In the case of *Caley v. Gulfstream Aerospace Corp.*,<sup>130</sup> Gulfstream developed a dispute resolution policy that would apply to their employees. They mailed the policy to their employees with a notice that if the employees continued working for Gulfstream, they would become bound by the new policy, regardless of explicit assent.<sup>131</sup> The employees sued their employer and argued that they should not be contractually bound to a policy they never expressly agreed to. In other words, they had given no valid consideration in exchange for their agreement to the new policy. The common law court hearing the case concluded that the policy was an offer that would be accepted upon completion of the performance specified in the terms, namely, continuing to work for the employer.<sup>132</sup> The consideration consisted of the bargain concluded

---

129. Von Mehren, *supra* note 25, at 688–89.

130. *Caley v. Gulfstream Aerospace Corp.*, 428 F.3d 1359 (11th Cir. 2005).

131. *Id.* at 1366.

132. *Id.* at 1374.

by the parties that allowed the employees continued employment in exchange for the acceptance of the new terms. Thus, the contract was deemed valid.

In the widely cited *Pennzoil v. Texaco* case, Pennzoil sued Texaco for tortious interference with a contract, a claim requiring proof of the existence of a contract.<sup>133</sup> Texaco argued that Pennzoil and the third party had neither definitively agreed on terms, nor completed the formalities of forming a binding contract. The question was put to the jury—had the parties expressed, in words or deeds, the intent to be bound by the terms of the memorandum of agreement? The jury found that the circumstances surrounding the negotiations of the parties and their subsequent public statements about a deal were sufficient to prove that they had reached an agreement. The jury ultimately awarded Pennzoil \$10.53 billion, which included a large punitive damage award only available in a contract dispute where a tort is also alleged.<sup>134</sup>

Finally, as a corollary to the illusory promises I discuss below, the absence of consideration can empower a party to change the terms of what the other party may have believed to be an agreement. Consider the case of *Garber v. Harris Trust & Savings Bank*, in which a bank attempted to unilaterally change the terms of credit for its credit card holders.<sup>135</sup> The bank argued that since the card holders took on no obligation in receiving the card (prior to usage of the card), the bank was merely making an offer and was free to change the terms of that offer at any time prior to acceptance.<sup>136</sup> The court agreed and found no consideration in the initial approval of the cardholder's application or distribution of the card.<sup>137</sup>

These cases reflect the willingness of a common law court to find a contract so long as the basic elements of formation have been met—intent, offer, acceptance and consideration. Formalities, such as signatures, notarization, and express manifestations of assent are unnecessary in the presence of evidence of a bargain. The next Section will discuss the importance of not only including consideration in the contract, but in proving that it was bargained for.

#### *B. Contracts with Intent but no Bargained-for-Exchange*

In the *Locator of Missing Heirs* case, the K-Mart Corporation entered into a contract with a company claiming that it would locate information about a potential class action lawsuit that might benefit K-Mart.<sup>138</sup> K-Mart would give Locator a 20% finder's fee if they provided information to K-Mart about the

---

133. *Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1 (1987).

134. *Texaco, Inc. v. Pennzoil Co.*, 729 S.W.2d 768 (Tex. App. 1987).

135. *Garber v. Harris Trust & Savings Bank*, 432 N.E.2d 1309 (Ill. App. Ct. 1982).

136. *Id.* at 1311.

137. *Id.* at 1315-1316.

138. *Locator of Missing Heirs, Inc. v. Kmart Corporation*, 33 F. Supp. 2d 229 (W.D.N.Y. 1999).

suit.<sup>139</sup> The parties clearly intended to go forward with the contract at the moment of agreement. However, unbeknownst to the K-Mart representative signing the contract with Locator, other K-Mart representatives had already received information about this suit and filed their own claim without any knowledge of the agreement with Locator.<sup>140</sup> The question in the case was whether a promise of information in exchange for a finder's fee constituted a bargained-for-exchange sufficient under the common law to form a valid contract.<sup>141</sup> The court found here that it did not.<sup>142</sup> Locator refused to nullify the agreement because the official date of the filing was after the signing of the agreement.<sup>143</sup>

The Court found there was no consideration to make the contract binding and valid.<sup>144</sup> The Court first explained that information may serve as valid consideration, but not when the information provided was known prior to bargain. The Court explained that "information may be a valid consideration for a promise. . . [h]owever, to constitute a valid consideration, the information must be new or novel and valuable, or thought to be so."<sup>145</sup>

The Court determined that knowledge of the claim prior to the signing of the contract was valid as a defense, not necessarily the date of filing.<sup>146</sup> In addition, the information provided no role in the filing of the claim as other attorneys were working prior to the agreement in anticipation of a claim in the antitrust suit, without any knowledge of Locator's services.<sup>147</sup> In sum, the Court found that the information provided was not new or novel and the agreement to pay a finder's fee was void for lack of consideration.<sup>148</sup>

### *C. Adequacy of the Consideration – How Much is Enough?*

Common law courts, unlike many civil law courts, rarely evaluate the adequacy or amount of the consideration exchanged between the parties.<sup>149</sup> In other words, the value given-up in exchange for the value received do not have

---

139. *Id.* at 230.

140. *Id.*

141. *Id.* at 232.

142. *Id.* at 234.

143. *Id.* at 230–31.

144. *Id.* at 233 ("[I]t is well settled that information may be a valid consideration for a promise to pay for it, and may be the subject of bargain and sale, or of contract . . . . However, to constitute a valid consideration, the information must be new or novel and valuable, or thought to be so.") (citing *Singer v. Karron*, 162 Misc. 809 (N.Y. Mun. Ct. 1937)).

145. *Locator of Missing Heirs, Inc.*, 33 F. Supp. 2d. at 233 (citing *Singer v. Karron*, 162 Misc. at 809, 811 (1937)).

146. *Locator of Missing Heirs, Inc.*, 33 F. Supp. 2d. at 234.

147. *Id.*

148. *Id.*

149. *See, e.g.*, *Wood v. Lucy, Lady Duff Gordon*, 118 N.E. 214 (N.Y. 1917).

to be equal in common law contracts, and rarely are. If a party chooses to make a bad deal, that is their choice and a common law court will not consider the difference in value between the amounts of consideration given by each party as a factor in finding an enforceable contract.<sup>150</sup> As long as there is some bargained-for consideration, a common law court will generally be satisfied that the parties intended their promises to be binding.

Consider the seventeenth century case of *Sir Anthony Sturlyn v. Albany*, in which the defendant leased property from the plaintiff landlord and was two years in arrears on the rent.<sup>151</sup> When the plaintiff demanded payment, the defendant informed him that if he could prove that the defendant was in fact two years in arrears and a deed showing the rent was due, he would pay the amount in full.<sup>152</sup> The plaintiff produced the deed and the defendant still refused to pay.<sup>153</sup> When the plaintiff sued, the defendant alleged that producing the deed was not adequate consideration to form a binding contract.<sup>154</sup> The court disagreed and found that “when a thing is to be done by a party to whom the promise is made, be it ever so small, this is a sufficient consideration to support an action.”<sup>155</sup>

#### D. Contracts with Illusory Promises

Adequacy of consideration is a prominent issue in cases of illusory promises. These are promises that fail to place the promisor at any serious risk and fail to create a true commitment. The canonical case illustrating this principle is *Wood v. Lucy, Lady Duff-Gordon*, decided in 1917 by Justice Cardozo, who was then serving on the New York Court of Appeals.<sup>156</sup> This case involved fashion designer and Titanic disaster survivor Lucy, Lady Duff Gordon, who agreed to give exclusive license to an advertising agent, Otis Wood, to market and sell her designs for a period of one year.<sup>157</sup> Half of all revenues received by Wood from these sales were to go to Lady Duff-Gordon.<sup>158</sup> The contract did not specify any minimum level of effort that Wood had to expend, but it did prevent Lady Duff-Gordon from selling her goods through any other means.<sup>159</sup>

---

150. See, e.g., CORBIN ON CONTRACTS § 28.39 (2015) (explaining that in order for a unilateral mistake to allow rescission of a contract, the party against whom enforcement is sought must suffer an unconscionable hardship and avoidance must not pose a substantial hardship on the other party).

151. Cro. Eliz. 67, 78 Eng. Rep. 327 (1587).

152. *Id.*

153. *Id.*

154. *Id.*

155. *Anthony Sturlyn v. Albany* (1587) 78 Eng. Rep. 327, 328; 29 and 30 Cro. Eliz. 67, 68.

156. *Wood*, 118 N.E. at 214.

157. *Id.* at 90.

158. *Id.*

159. *Id.*

Shortly after entering into this agreement, Lady Duff-Gordon developed a new product line that she chose to market through Sears Roebuck, thereby violating her agreement with Wood.<sup>160</sup> Wood sued Lady Duff-Gordon for breach of contract, and Lady Duff-Gordon contended that there was no contract because Wood's promise was illusory.<sup>161</sup>

Justice Cardozo disagreed with Lady Duff-Gordon's argument.<sup>162</sup> The court found that Wood had implicitly agreed to use reasonable efforts to market Lady Duff-Gordon's clothing in exchange for the exclusive right to do so.<sup>163</sup> Lady Duff-Gordon had also covenanted to account monthly for all sales and to take out all necessary patents on the clothing he contracted to sell.<sup>164</sup> Despite the fact that no sales had been made, Wood promised Lady Duff-Gordon half of the sales profits from his reasonable efforts in exchange for this license.<sup>165</sup> This was sufficient consideration for Justice Cardozo to find a bargained-for-exchange.<sup>166</sup> However, one might have argued that the value of withholding a right to sell your goods in exchange for an implied promise to use best efforts is quite unequal.

An illusory promise exists where the promisor has shrouded his or her commitment in language that provides a release from liability should the promisor choose to use it.<sup>167</sup> In other words, it binds only one of the parties to the agreement. An illusory promise lacks consideration and will generally be found not to form a valid and enforceable contract, leaving the promisee in most cases without a remedy.<sup>168</sup>

Consider the oft-cited case of *Universal Computer Systems, Inc., v. Medical Services Association of Pennsylvania*.<sup>169</sup> In that case, Universal was attempting to submit a bid on a contract with Blue Shield but could not get it to Blue Shield by mail on time.<sup>170</sup> A representative from Universal phoned a Blue Shield

---

160. *Id.*

161. *Id.*

162. *Id.* at 215.

163. *Id.* at 214–15.

164. *Id.* at 215 (“[Wood’s] promise to pay the defendant one-half of the profits and revenues resulting from the exclusive agency and to render accounts monthly, was a promise to use reasonable efforts to bring profits and revenues into existence.”).

165. *Id.*

166. *Id.* at 92.

167. See CORBIN ON CONTRACTS § 5.28 (2015) (describing an illusory promise as one that does not put any limitation on the freedom of the alleged promisor).

168. But see Michael B. Metzger & Michael J. Phillips, *Promissory Estoppel and Reliance on Illusory Promises*, 44 SW. L. J. 841, 842–43 (1990) (arguing that while promissory estoppel will not generally remedy an illusory promise, courts often find creative remedies to protect an injured promisee who committed to an illusory promise).

169. *Universal Comput. Sys., Inc., v. Med. Serv. Ass’n of Pa.*, 474 F. Supp. 472 (M.D. Pa. 1979).

170. *Id.* at 475.

employee and asked the employee if he would agree to meet a plane carrying the bid at the airport, which Universal would arrange.<sup>171</sup> The employee agreed and Universal sent the bid via an express air carrier.<sup>172</sup> However, the employee chose not to pick up the bid and Universal, which had the lowest bid, was not awarded the contract.<sup>173</sup> The court here concluded that the employee had given no consideration in exchange for his promise to pick up the bid and thus made only an illusory promise.<sup>174</sup>

In *Mattei v. Hopper*, the plaintiff offered to purchase a lot from the defendant and made a \$1,000 deposit in support of this promise.<sup>175</sup> The parties signed a contract that contained a “satisfaction” clause, which excused the plaintiff from performance if he did not find leases satisfactory to him for the property within 120 days, which was to be developed into a shopping center.<sup>176</sup> Prior to the end of the satisfaction period, the defendant chose to cancel the sale.<sup>177</sup> When the plaintiff sued for breach, the defendant claimed that Mattei’s promise was illusory due to the satisfaction clause.<sup>178</sup>

The court in *Mattei* explained that a satisfaction clause is not necessarily illusory so long as there is a reasonable mechanism to assess whether the party has in fact been satisfied.<sup>179</sup> In commercial contracts where satisfaction is based upon identifiable standards used in commercial practice, a satisfaction clause is not illusory because parties relinquish some discretionary power.<sup>180</sup> Likewise, when satisfaction is dependent upon the tastes or judgment of the party, so long as the party subject to the clause has acted in good faith in making that determination, the clause does not render the contract invalid due to illusory consideration.<sup>181</sup>

Conditions can be used to design a valid exit strategy for careful parties under certain circumstances; however, if they are drafted so as to avoid creating any legal obligation, a court will deny enforcement of the contract. These classic common law cases highlight the importance of including sufficient and

---

171. *Id.*

172. *Id.*

173. *Id.*

174. *Id.* at 477.

175. *Mattei v. Hopper*, 330 P.2d 625, 625–26 (Cal. 1958).

176. *Id.* at 626 (“Subject to Coldwell Banker & Company obtaining leases satisfactory to the purchaser.”).

177. *Id.*

178. *Id.*

179. *Id.* at 628–29 (finding that language referring to “reasonable judgment” would create an implied requirement of good faith).

180. *Id.* at 628.

181. *Mattei v. Hopper*, 51 Cal.2d 119, 124 (1958) (citing *Tiffany v. Pac. Sewer Pipe Co.*, 180 Cal. 700, 702–705, 182 P. 428). But see *J. C. Millett Co. v. Park & Tilford Distillers Corp.*, 123 F. Supp. 484, 493 (N.D. Cal. 1954) (allowing withdrawal based upon unrestricted interpretations of pleasure as illusory).



identifiable consideration in contracts to ensure that common law courts will enforce them.

In the *NCSPPlus, Inc.* case from 2012, a landlord attempting to collect nearly \$150,000 in delinquent payments entered into a contract with a collection agency to assist with his efforts.<sup>182</sup> The terms of the contract allowed the collection agency to receive a withdrawal fee from the landlord if the landlord removed any accounts from the collection process, amounting to the full collection fee had the debt been collected (liquidated damages).<sup>183</sup> The agency collected only \$750 over two years and made little effort to collect on the remaining debts, so the landlord withdrew all of the accounts.<sup>184</sup> The agency tried to recover the withdrawal fees for the removed accounts.<sup>185</sup>

The landlord in this case argued that the collection agency never obligated itself to do anything.<sup>186</sup> Here, since the agency was receiving withdrawal fees in exchange for no commitment to act on their part, the court concluded that they had made an illusory promise.<sup>187</sup> The contract failed for lack of valid consideration.<sup>188</sup>

In a similar case, *Fakhoury Enterprises, Inc. v. J.T. Distributors*, a firm entered a contract with an air freshener manufacturer to operate a distribution franchise in a given territory.<sup>189</sup> The contract explained most of the terms of the distribution arrangement; however, it failed to specify a quantity of air fresheners that would be sold, leaving that element to be decided later by the parties.<sup>190</sup> “Later” never came. The firm never ordered any air fresheners from the distributor.<sup>191</sup> When the distributor sought other firms to work within the same territory, the original firm sued, claiming breach of their contract. At trial, the distributor argued that there was no consideration—the promise made by the firm was illusory.<sup>192</sup> The court agreed, stating that under the Uniform Commercial Code (UCC) this exchange might have been sufficient to form a valid contract under principles of good faith.<sup>193</sup> However, as the UCC is not

---

182. *NCSPPlus Inc. v. WBR Mgmt. Corp.*, 949 N.Y.S. 2d 317, 319–20 (Sup. Ct. 2012).

183. *Id.* at 319–20.

184. *Id.* at 320.

185. *Id.*

186. *Id.*

187. *Id.* at 325. *But see* *Wood v. Lucy, Lady-Duff Gordon*, 188 N.E. 214, 215 (N.Y. 1917) (finding that Wood was required to make reasonable efforts to sell Lucy’s line of clothing).

188. *NCSPPlus Inc.*, N.Y.S. 2d 317 at 325.

189. *Fakhoury Enters., Inc. v. J.T. Distribs.*, No. 94 CIV. 2729 (PKL), 1995 WL 424990, at \*1 (S.D.N.Y. July 19, 1995).

190. *Fakhoury Enters. v. J.T. Distribs.*, 1997 U.S. Dist. LEXIS 7667 at 3.

191. *Id.* at 5–6.

192. *Id.* at 8–9.

193. *Id.* at 10.

applicable to most service agreements like this, strict adherence to common law rules is required and strict consideration rules are followed<sup>194</sup>

Distinguish these cases from the approach in civil law. In the case of *Blanche Raymond v. Varlet*, an actress signed a contract with Gaiete Rochechouart Concerts to give performances over three seasons between 1894 and 1897.<sup>195</sup> The director reserved the exclusive right to terminate the contract at the end of each month without the performer having any right to indemnity.<sup>196</sup> Blanche refused to perform and the company brought suit to claim a penalty for non-performance.<sup>197</sup> The Paris Court of Appeals held that the ability to terminate a contract with impunity creates no true obligation and thus no valid cause for the contract, finding this result consistent with Article 1174 of the civil code.<sup>198</sup> However, the French Court de Cassation reversed the Paris court, finding that a one-sided transaction can still be binding even if that party's obligation can be terminated at will.<sup>199</sup>

### *E. Back to the Future - Past Consideration*

A promise that is made in exchange for a thing already done will not form an enforceable contract.<sup>200</sup> This is the problem of past consideration. For the consideration to be valid, it must be made in the present at the same time the contract is formed.<sup>201</sup> The concept is based on the idea that a gift given without expectation of payment cannot later be used as a justification for a demand. "For it is not reasonable that one man should do another a kindness, and then charge him with a recompense: this would be obliging him whether he would or not, and bringing him under an obligation without his concurrence."<sup>202</sup> For example, in the case of a party that promises to pay the previously acquired debts of another, a court concluded that no valid contract was formed due to lack of consideration.<sup>203</sup> Again, a court found a contract invalid where a father promised

---

194. *Id.*

195. *Blanche Raymond v. Varlet*, cour d'appel [CA] [regional court of appeal] Paris, 5e ch., April 26, 1898., D. 1898. II. 526.

196. *Id.*

197. *Id.*

198. See BERNARD SCHWARTZ, *THE CODE NAPOLEON AND THE COMMON LAW WORLD* 131 n.7 (1954); Arthur T. Von Mehren, *supra* note 95, at 1025.

199. See *Varlet v. Blanche Marie*, Cour de Cassation [Cass.] [supreme court for judicial matters] ch. civ., March 1, 1899 (Fr.).

200. *Mills v. Wyman*, 20 Mass. (3 Pick.) 207 (1825).

201. See, e.g., *Webb v. McGowin*, 168 So. 196 (Ala. Ct. App. 1935) (finding a promise made subsequent to an act being committed to lack valid consideration).

202. COMYN, *supra* note 5, at 19.

203. *Rohrscheib v. Helena Hosp. Ass'n*, 670 S.W.2d 812 (Ark. Ct. App. 1984) (reversing a lower court decision that had found an enforceable contract where a third-party signed a hospital release for his sister under the heading "responsible party," leading the hospital to bill that third-party \$4,000 for services rendered to the patient).

a Good Samaritan to pay the costs to care for his dying son after the care had already been rendered, maintaining a clear distinction between gratuitous acts and acts induced by promise.<sup>204</sup>

In the commercial context, if a seller concludes a contract with a buyer whereby the seller agrees to sell his yacht for the sum of \$1 million, and then later the seller warrants that the yacht is free from any defects, the warranty is unenforceable for lack of valid consideration.<sup>205</sup> In a case such as this, the buyer would be wise to include such warranty in the original sales contract or to offer some additional consideration in exchange for the subsequent warranty. “A promise given in consideration of past services voluntarily rendered without the promisor’s privity or request is purely gratuitous and creates no legal liability.”<sup>206</sup>

There are some exceptions to this rule worth noting. The first is the *material benefit* exception. If a party performs a service, pays a sum of money, or procures a good on behalf of another without the other’s knowledge, and the beneficiary subsequently agrees to receive that service, money, or good, the law considers this a previous request and shrouds it in implied consideration.<sup>207</sup>

This theory has been applied in cases of moral consideration. Courts have been consistent in their denial of moral bases to support valid consideration.<sup>208</sup> For instance, in *Webb v. McGowin*,<sup>209</sup> Webb, a lumberyard worker, saved the life of McGowin by jumping onto and diverting a falling block of pine that would have crushed McGowin had it continued its trajectory to the ground. After doing so, McGowin promised to pay Webb, who was severely crippled from the fall, \$15 every two weeks for the rest of his life. Upon McGowin’s death, his estate refused to continue making payments. The court found that McGowin had received a material benefit that he would reasonably be expected

---

204. *Mills*, 20 Mass. (3 Pick.) at 207.

205. *See, e.g.*, SAMUEL COMYN, THE LAW OF CONTRACTS AND PROMISES UPON VARIOUS SUBJECTS AND WITH PARTICULAR PERSONS AS SETTLED IN THE ACTION OF ASSUMPSIT 21 (1835) (discussing a similar exchange involving a horse).

206. WILLIAM FREDERICK ELLIOTT, COMMENTARIES ON THE LAW OF CONTRACTS 360 (1913).

207. *See, e.g.*, *Ferguson v. Harris*, 39 S.C. 323, 333 (1893) (finding a contract made by a married woman, which at the time would be unenforceable, to purchase lumber enforceable when the woman received and used the lumber); *Lycoming Cty. V. Union Cty.*, 15. Pa. 166, 171 (1850) (receipt of a moral benefit through legislation); *see also* COMYN, *supra* note 5, at 23.

208. *See, e.g.*, Kevin M. Teeven, *A Legal History of Binding Gratuitous Promises at Common Law: Justifiable Reliance and Moral Obligation*, 43 DUQ. L. REV. 11, 64-66 (2004); *see also* Muir v. Kane, 55 Wash. 131, 135 (1909) (“It is clear that if a contract between two parties be void, and not merely voidable, no subsequent express promise will operate to charge the party promising, even though he has derived the benefit of the contract.”). *But see*, *Webb v. McGowin*, 27 Ala. App. 82, 85 (1935) (“It is well settled that a moral obligation is a sufficient consideration to support a subsequent promise to pay where the promisor has received a material benefit, although there was no original duty or liability resting on the promisor.”).

209. *Webb v. McGowin*, 27 Ala. App. at 85.

to pay for; thus, having accepted to make such payments, this became a *previous request*.<sup>210</sup>

Similarly, in *Boothe v. Fitzpatrick*, a bull escaped from its owner's keep and was subsequently caught and cared for by a third-party. The court found that the subsequent promise to pay by the owner constituted a *previous request* and thus valid consideration.<sup>211</sup> The basic tenet is that for past consideration to be validated by the court, there must be a material benefit given by the promisor to the promisee that a reasonable promisee would be expected to accept, and in fact accepted. The court will then bring that past promise forward to make it present consideration.

Civil law courts have been more willing to accept gratuitous or moral promises as binding than common law courts. Consider *Guidez v. Thuet*, in which a husband promised a woman 2,000 francs in exchange for her previous care of the husband's dying wife.<sup>212</sup> The husband refused to pay, claiming it was an unenforceable donation. The court found for the woman, holding that the agreement was to fulfill a natural obligation, which was in itself obligatory.<sup>213</sup> Similar results can be found in cases involving debts to a hospital for caring for a sick patient,<sup>214</sup> promises to pay an additional sum after a contract for the sale of land had already been concluded,<sup>215</sup> and promises to reimburse for losses suffered due to bad investment advice.<sup>216</sup>

It should be noted that the French courts differentiate between moral duties and natural obligations. Though no clear distinction exists in the civil code, courts have drawn a line between the two, only finding natural obligations enforceable, similar to a nominal claim in the common law.<sup>217</sup> As an example, consider *Darier v. Dubois*, in which a man promised to pay his mistress an annuity for support of her and her child while she was away from her husband.<sup>218</sup> He supported her for nearly fifteen years with large sums, but when

210. For an interesting commentary on this case, see Stephen J. Leacock, *Echoes of the Impact of Webb v. McGowin on the Doctrine of Consideration under Contract Law: Some Reflections on the Decision on the Approach of Its 75th Anniversary*, 1 FAULKNER L. REV. 1 (2010).

211. *Boothe v. Fitzpatrick*, 36 Vt. 681, 683–84 (1864).

212. *Guidez v. Thuet*, cour d'appel [CA] [regional court of appeal] Douai, 2e ch., July 2, 1847 (Fr.).

213. See also Von Mehren, *supra* note 95, at 1039.

214. *Pages v. Freres Saint Jean-de-Dieu*, Cass. req. [ordinary court of original jurisdiction] Lyon, May 5, 1868 (Fr.).

215. *Jouanne v. Berruyer*, Cass. req. [ordinary court of original jurisdiction] Nov. 21, 1831 (Fr.).

216. *Carpentier v. Enchery*, Tribunal Civil de la Seine, June 27, 1911, *reprinted in* ARTHUR VON MEHREN, *THE CIVIL LAW SYSTEM: CASES AND MATERIALS FOR THE COMPARATIVE STUDY OF LAW* (1957).

217. See, e.g., David V. Snyder, *The Case of Natural Obligations*, 56 LA. L. REV. 423, 424 (1996).

218. *Darier v. Dubois*, cour d'appel [CA] [regional court of appeal] Paris, 8e ch., Nov. 5, 1925 (Fr.).

she married a wealthy man, he sent a wedding gift and then ceased the annuities. She sued, and the court held that this was “only a simple moral duty. . .and not a natural obligation.”<sup>219</sup>

#### F. Contracts Based Upon Existing Duties

A contract cannot be formed on the basis of a promise previously made or an action already performed.<sup>220</sup> This is the basis of the preexisting duty problem. The issue first came up, as might be expected, in a debt case. In *Pinnel's Case*, Pinnel sued Cole over a debt agreement in which Cole owed eight pounds and ten shillings.<sup>221</sup> Cole alleged to the court that he paid five pounds and two shillings prior to the due date for the debt as full payment. Pinnel contended that this was mere partial payment. The court concluded that payment of part of a debt, without some additional consideration, could not modify the terms of the original contract.<sup>222</sup>

The original purpose for the preexisting duty rule was to prevent parties from attempting to modify existing contracts without a new bargain.<sup>223</sup> As seen in *Pinnel's Case* above, and many cases since,<sup>224</sup> this rule requires new consideration to make any new promise, whether a new contract or the modification of an existing contract. And though the rule has not received high favor among scholars,<sup>225</sup> it remains an important tool to verify the intent of the parties.

Renowned contracts scholar Arthur Corbin argued in a 1918 law review article that “[t]he law does not define consideration as the sole inducing cause of a contractor’s action, and if it were so defined a valid contract would seldom be made.”<sup>226</sup> Yet while it may be true that consideration does not stand alone in proving the existence of a valid contract (intent is also a crucial element),

---

219. *Id.*

220. See, e.g., Kevin M. Teeven, *The Advent of Recovery of Market Transactions in the Absence of a Bargain*, 39 AM. BUS. L.J. 289, 347-53 (2002).

221. *Pinnel's Case* (1602) 5 Co. Rep. 117a (Eng.).

222. *Pinnel's Case* (1602) 5 Co. Rep. 117a (Eng.).

223. Mark B. Wessman, *Retraining the Gatekeeper: Further Reflections on the Doctrine of Consideration*, 29 LOY. L.A. L. REV. 713, 731 (1996) (describing the “policing” function of the rule in post-formation contracts).

224. *Id.* at 732 (citing *Arden Equip. Co. v. Rhodes*, 285 S.E. 2d 874 (N.C. Ct. App. 1982)) (finding a debtor’s promise to return leased equipment to the owner voluntarily after default did not constitute an enforceable promise since they were already obligated to return the equipment); *Foakes v. Beer* (1884) 9 App. Cas. 605 (HL) (refusing to enforce a creditor’s promise to waive interest on an outstanding debt so long as it was paid back).

225. See, e.g., Kevin M. Teeven, *Consensual Path to Abolition of Preexisting Duty Rule*, 34 VAL. U. L. REV. 43 (2000); Wessman, *supra* note 193, at 729–32.

226. Arthur Corbin, *Does a Preexisting Duty Defeat Consideration?* 366 (YALE FAC. SCHOLARSHIP SERIES, Paper 2870, 1918), [http://digitalcommons.law.yale.edu/fss\\_papers/2870](http://digitalcommons.law.yale.edu/fss_papers/2870).

without it, common law courts are unlikely to enforce the promises made by the parties.

*Pinnel's* case is an important one for illustrating the distinction between pure common law contracts and commercial sales contracts. In the former category are contracts for services, contracts for real property, and mixed contracts in which the majority element of the contract is one of these two things. Contracts with common law parties in this category would be subject to the strict common law consideration rules discussed above. However, a commercial contract for the sale of goods with a common law party is subject to special rules under the American contracts statute, the UCC, or internationally under the CISG. The next Section addresses these codes.

#### IV.

##### SALE OF GOODS CONTRACTS

Proving that a contract has sufficient consideration in common law contracts is less problematic in goods contracts than it is in service or real property contracts. This is largely the result of two important statutes governing sales of goods—the UCC and the CISG. While the CISG dispenses entirely with consideration (discussed below), the UCC makes it easier to prove. It bears repeating that these acts apply only to commercial goods contracts.

##### A. *The Uniform Commercial Code*

The UCC is a uniform law adopted by all states that attempts to streamline the process of contracting across states within the United States. Drafted by the American Law Institute and the National Conference of Commissioners on Uniform State Laws, the UCC was first published in 1952.<sup>227</sup> As a model code, the UCC is not a law itself. Rather, it is a uniform code of principles that states would choose to adopt, modify or ignore. Given the broad interest in reducing the cost of doing business, each state adopted the uniform law into its own legal code.<sup>228</sup>

The UCC governs contracts between parties when those contracts involve the sale or lease of goods, negotiable instruments, or a related commercial exchange. Specifically excluded from the coverage of the UCC are service contracts, real property contracts, and currency contracts.<sup>229</sup> If a contract

---

227. See Robert Braucher, *The Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798, 800 (1958).

228. See, e.g., Christian Paul Callens, *Louisiana Civil Law and the Uniform Commercial Code: Interpreting the New Louisiana U.C.C.-Inspired Sales Articles on Price*, 69 TUL. L. REV. 1649, 1651 (1994) (discussing the civil law heritage of Louisiana and its effect on that state's adoption of the UCC).

229. See U.C.C. §§ 2-105, 107 (AM. LAW INST. & UNIF. LAW COMM'N 1977) (defining "goods").

includes both goods and services, such as a product design contract, the UCC will govern only if the goods component of the contract is more valuable than the services component.<sup>230</sup> In cases in which the UCC does not apply, common law will govern the interpretation and enforcement of the contract.

Unlike the CISG, the UCC maintains the need for consideration in commercial contracts. Though not defined in Article I (definitions), the UCC describes consideration in Article 3-303, referring to the enforcement of negotiable instruments, as follows:

[A]ny consideration sufficient to support a simple contract. The drawer or maker of an instrument has a defense if the instrument is issued without consideration. If an instrument is issued for a promise of performance, the issuer has a defense to the extent performance of the promise is due and the promise has not been performed. If an instrument is issued for value as stated in subsection (a), the instrument is also issued for consideration.<sup>231</sup>

Accordingly, contracts formed under the UCC should expressly denote the valuable consideration being exchanged between the parties in order to ensure enforceability. I will discuss mechanisms for denoting consideration properly later. However, it should be noted that the UCC does offer a few exceptions to this rule:

### 1. *Firm Offers*

Under UCC § 2-205, a merchant who makes a written offer to a buyer that promises to hold that offer open for a given period of time and who signs that offer forms a binding agreement with the buyer despite any lack of consideration.<sup>232</sup> This rule imposes a higher standard on merchants than consumers in making offers by locking them into their promises without requiring the consumer to provide any consideration. The common law rule would allow the seller to revoke their offer at any time prior to acceptance.<sup>233</sup>

The UCC firm offer rule picks up where the common law concept of reliance leaves off. Detrimental reliance, or promissory estoppel, gave a promisee a remedy if they foreseeably relied upon the promise of another and suffered harm as a result.<sup>234</sup> This remedy left parties in this position helpless if they could not prove both foreseeable reliance and harm.

---

230. See, e.g., *Fleet Bus, Credit, LLC, v. Grindstaff, Inc.*, No. W2007-01341-COA-R3-CV, 2008 WL 2579231 (Tenn. Ct. App. June 30, 2008) (explaining that the amounts charged for the good and service, in addition to other factors, will determine whether the UCC or common law govern the transaction).

231. U.C.C. § 3-303 (AM. LAW INST. & UNIF. LAW COMM'N 1977).

232. *Id.* at § 2-205 (AM. LAW INST. & UNIF. LAW COMM'N 1977).

233. See, e.g., *Cooke v. Oxley* [1790] 3 TR 653 (Eng.) (allowing a defendant to withdraw an offer that he promised to hold open for a specified period of time); see also *Morrison v. Thaelke*, 155 So. 2d 889, 898 (Fla. Dist. Ct. App. 1963).

234. See *Drennan v. Star Paving*, 333 P.2d 757, 760 (Cal. 1958).

## 2. *Missing Terms*

In certain cases, the UCC will allow a contract to be formed even if some essential terms are missing. “Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.”<sup>235</sup> Likewise, a goods contract where the buyer agrees to purchase all of a given seller’s output, even though a specific quantity is not specified, will not fail due to a lack of valid consideration.<sup>236</sup> The same is true of a contract in which a seller agrees to sell all that he can produce to a given buyer. Under the common law, these indefinite contracts could be challenged for lacking consideration since the parties never explicitly agreed on the nature of the exchange.<sup>237</sup>

## 3. *Contract Modifications*

Once a contract has been formed, making changes to that contract requires the parties to agree upon new terms—modifications. In theory, these new terms dispense with the original agreement and form a new agreement altogether. For this reason, the common law requires that modifications to contracts include new consideration to be valid.<sup>238</sup> This can be cumbersome for long-term and frequently modified contracts, so the UCC eliminated the requirement that additional consideration be identified for contract modifications in the case of sales contracts.<sup>239</sup> Section 2-209 of the UCC arose out of the awareness that “merchants and industrial managers preferred settling contract breakdowns outside the courts and often without concern about the contract’s requirements.”<sup>240</sup> Courts have validated this practice. For instance, in *Gross Valentino Printing Co. v. Clarke*,<sup>241</sup> the court upheld a contract modification that raised the price for the printing of magazines after the contract had been performed despite the lack of any new consideration for the increased price.

---

235. U.C.C. § 2-204(3) (AM. LAW INST. & UNIF. LAW COMM’N 1977).

236. *Id.* at § 2-306 (AM. LAW INST. & UNIF. LAW COMM’N 1977).

237. However, bear in mind that most quantity-based contracts involve the sale of goods and thus would be governed by the U.C.C. See, e.g., *Acad. Chi. Publishers v. Cheever*, 578 N.E.2d 981, 983–84 (Ill. 1991) (finding a publishing contract unenforceable where parties excluded essential terms such as the number of stories to be published and the delivery date for the manuscript); *Joseph Martin Jr. Delicatessen v. Schumacher*, 417 N.E.2d 541, 543–44 (N.Y. 1981) (finding a lease that included a renewal term specifying the price “to be agreed upon” to be insufficiently definite to form a valid contract); Nellie Eunsoo Choi, *Contracts with Open or Missing Terms under the Uniform Commercial Code and the Common Law: A Proposal for Unification*, 103 COLUM. L. REV. 50 (2003).

238. See Corbin, *supra* note 196, at 366.

239. UCC § 2-209(1) (AM. LAW INST. & UNIF. LAW COMM’N 1977).

240. Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 61–62 (1963).

241. *Gross Valentino Printing Co. v. Clarke*, 458 N.E.2d 1027, 1030 (Ill. App. Ct. 1983).



Likewise, the CISG, which is silent regarding consideration anyway, allows parties to modify their contracts with “mere agreement.”<sup>242</sup>

To summarize, new commercial contracts and common law contracts must have an explicit exchange of consideration in order to ensure their enforceability. I will next turn to the CISG.

### *B. The Convention on the International Sale of Goods*

The CISG makes no mention of consideration whatsoever and it includes two articles that effectively override the consideration problem in practice. The lack of a consideration requirement is the result of the strong influence of civil law countries in the original drafting of the CISG rules, which overpowered the largely American push to include mechanisms that would equate CISG contracts to common law contracts. As one author noted on this matter, “the CISG was bold enough to abolish a time-honoured though disputed legal institution that is part of many national laws.”<sup>243</sup>

It is important to note at the outset that the CISG does not govern all contracts. It will only apply in cases in which all of the following are true:

- Both parties are merchants;
- The transaction is for the sale of goods;
- The merchants maintain their principal place of business within a CISG member state (81 parties as of September 2014); and,
- The parties have not opted-out of the CISG by contract.<sup>244</sup>

The CISG arose out of the efforts of English, German, French and Scandinavian scholars who joined forces to form UNIDROIT (the International Institute for the Unification of Private Law) in 1929.<sup>245</sup> An initial attempt to form an international law governing sales transactions was made by UNIDROIT in 1964. At that meeting, UNIDROIT members, including the United Kingdom, adopted the Uniform Law of International Sales and the Convention Relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods.<sup>246</sup> However, as these conventions were seen as largely drafted for and

---

242. United Nations Convention on Contracts for the International Sale of Goods art. 29, Jan. 1, 1988, 1489 U.N.T.S. 3 [hereinafter CISG].

243. Ulrich Magnus, *The Vienna Sales Convention (CISG) Between Civil and Common Law—Best of All Worlds?*, 3 J. CIV. L. STUD. 67, 89 (2010).

244. See, e.g., *Martini E. Ricci v. Trinity Fruit Sales*, 30 F. Supp. 3d 954, 968 (E.D. Cal. 2014).

245. See, e.g., Joanne M. Darkey, *A U.S. Court's Interpretation of Damage Provisions under the U.N. Convention on Contracts for the International Sale of Goods*, 15 J. L. & COM. 139 (1996); E. Allan Farnsworth, *The Vienna Convention: History and Scope*, 18 INT'L L. 17 (1984).

246. Henning Lutz, *The CISG and Common Law Courts: Is There Really a Problem?*, 35 VICTORIA U. WELLINGTON L. REV. 711, 713 (2004).

biased toward civil law countries, they were not widely accepted at first, including by the United States.<sup>247</sup>

The United Nations Conference on International Trade Law (UNCITRAL) was established in 1966 and began with the initial lofty goal of forming an agreement on the international sale of goods that would encompass the principles of both civil and common law jurisdictions.<sup>248</sup> The Convention on the International Sale of Goods (CISG) was the result of this attempt to develop an international sales convention that would be acceptable by both civil and common law countries. The draft CISG was by UNCITRAL in 1978.<sup>249</sup> The United States ultimately ratified the convention in 1986 and it took effect in 1988.<sup>250</sup>

Though the CISG makes no mention whatsoever of the doctrine of consideration, notes from the drafting sessions suggest that parties from civil and common law jurisdictions attempted to assert principles inherent in their own legal systems.<sup>251</sup> In the end, however, consideration was left out of the document.<sup>252</sup> One possible explanation for the removal of consideration as a requirement for the formation of a contract under the CISG is that the convention only speaks to commercial contracts where both parties have express obligations.<sup>253</sup> Article 29 of the CISG, explained further below, dispenses with the requirement for consideration in the modification or termination of a contract, much like the UCC does for contract modifications.<sup>254</sup> However, the official commentary to that CISG article states that the CISG intended to

---

247. *Id.* at 712.

248. *See, e.g., id.* at 713; *see also* Rep. of the U.N. Comm'n on Int'l Trade Law on the Work of Its Second Session, U.N. Doc. A/7618, at 99-100, Mar. 3-31, 1969; GAOR, 24th Sess., Supp. No. 18 (1969).

249. U.N. Secretary-General, *Incorporation of the Provisions of the Draft Convention on the Formation of Contracts for the International Sale of Goods into the Draft Convention on the International Sale of Goods*, at 121, U.N. Doc. A/CN.9/145, (Mar. 29, 1978).

250. Mathias Reinmann, *The CISG in the United States: Why It Has Been Neglected and Why Europeans Should Care*, 71 RABEL J. COMP. & INT'L PRIV. L. 115, 117 (2007) (discussing the United States as one of the earliest adopters of the Convention, despite its minimal relevance in U.S. law).

251. Gyula Eorsi, *Common Law v. Civil Law*, in PROBLEMS OF UNIFYING LAW ON THE FORMATION OF CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS, PACE U. L. SCH., [http://www.jus.uio.no/pace/problems\\_of\\_unifying\\_law\\_on\\_formation\\_of\\_contracts\\_for\\_international\\_sog.gyula\\_eorsi/\\_4.html](http://www.jus.uio.no/pace/problems_of_unifying_law_on_formation_of_contracts_for_international_sog.gyula_eorsi/_4.html) (last visited Apr. 4, 2016).

252. *See* Lutz, *supra* note 216, at 721 (explaining that the official commentary to the CISG indicated an intent to overrule the consideration requirement).

253. Joseph D. Mattera, Comment, *The United Nations Convention on Contracts for the International Sale of Goods ("CISG") and Geneva Pharmaceuticals Technology Corp. v. Barr Laboratories, Inc. / Apothecon, Inc. v. Barr Laboratories, Inc.: The U.S. District Court for the Southern District of New York's Application and Interpretation of the Scope of the CISG*, 16 PACE INT'L L. REV. 165, 174 (2004).

254. UCC art. 2-209(1) (AM. LAW INST. & UNIF. LAW COMM'N 1977).

overrule and eliminate the requirement of consideration in all aspects of contract formation.<sup>255</sup>

The impact of this omission appears to be minimal since the majority of agreements governed under the CISG, which requires payment and delivery terms set forth in the agreement, would already include the foundational elements of valid consideration under common law rules. However, some authors have noted that these rules only govern the terms of the agreement between the contract parties; it would not cover any extra-contractual promises, such as warranties, that are not embodied in the agreement. This begs the question, would consideration ever become an issue in a dispute under a CISG-governed contract?

To answer this question, we must examine three specific articles of the statute—Article 4, 16 and 29. To begin, Article 16 limits the revocability of an offer prior to acceptance.

### *1. Revocation of Offers*

Under the common law, an offer not based on any valuable consideration from the offeree can be revoked at any time prior to acceptance. The Firm Offer Rule of the UCC discussed above allows an exception to this rule if a merchant makes the offer in writing and signs that offer. The CISG goes further and allows for both the merchant's rule of the UCC and a second exception for parties that reasonably rely on an offer to block the offeror's ability to revoke.

CISG Article 16 states:

- (1) Until a contract is concluded an offer may be revoked if the revocation reaches the offeree before he has dispatched an acceptance.
- (2) However, an offer cannot be revoked:
  - (a) if it indicates, whether by stating a fixed time for acceptance or otherwise, that it is irrevocable; or
  - (b) if it was reasonable for the offeree to rely on the offer as being irrevocable and the offeree has acted in reliance on the offer<sup>256</sup>

Accordingly, Article 16 allows offerees to form contracts without giving any consideration when those offers specify a response deadline or when they would be reasonably expected to rely on such offers.

---

255. *Secretariat Commentary, Guide to CISG Article 29*, PACE L. SCH. INT'L & COM L. (last updated Aug. 29, 2006), <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-29.html>; see also Petra Butler, *The Doctrines of Parol Evidence Rule and Consideration—A Deterrence to the Common Law Lawyer?*, Collation of Papers at UNCITRAL-SIAC Conference, Singapore (22-23 Sept. 2005), at 61–62.

256. CISG Art. 16.

## 2. *Contract Modifications*

To further purge the international commercial system of the historical requirement of consideration, Article 29 of the CISG specifically dispenses with the need for new consideration when modifying contracts. In part, that agreement notes that “[a] contract may be modified or terminated by the mere agreement of the parties.”<sup>257</sup> The official commentary to this Article explains that this language explicitly excludes consideration from this type of agreement. Keep in mind that new consideration is not required under the UCC either, but it is a certain requirement under common law contracts. *Shuttle Packaging Systems LLC v. Jacob Tsonakis*, discussed in more detail below, elaborates on this issue.

CISG Article 29 states the following:

- (1) A contract may be modified or terminated by the mere agreement of the parties.
- (2) A contract in writing which contains a provision requiring any modification or termination by agreement to be in writing may not be otherwise modified or terminated by agreement. However, a party may be precluded by his conduct from asserting such a provision to the extent that the other party has relied on that conduct.<sup>258</sup>

This Article allows an existing contract to be modified by either party upon mere agreement. The common law treats contract modifications as new agreements and thus requires new consideration before any party will be bound by a promise they make subsequent to the conclusion of their contract. The UCC has no such requirement for additional consideration—it tracks the language of the CISG for contract modifications.

These two articles confirm that there is no need for consideration to prevent revocation of most unilateral offers for a period of time or to modify existing contracts. But what about the formation of the contract itself when no such acceptance deadline is promulgated? This has generally been treated by courts as an issue of contract *validity*—an area that the CISG expressly defers to the domestic jurisdiction in which the contract was formed.

## 3. *Contract Validity*

Under CISG Article 4(a), local law determines validity of a contract.<sup>259</sup> This is one of the topics that was explicitly excluded from CISG coverage. However, neither the CISG nor associated case law clearly defines the term “validity.” It has generally been found to mean that the contract is not void, voidable or unenforceable.<sup>260</sup> The CISG, then, considers anything that would

---

257. CISG Art. 29.

258. CISG Art. 29(2).

259. *Id.* Art. 4(a).

260. *See, e.g.*, Helen Elizabeth Hartnell, Rousing the Sleeping Dog: The Validity Exception to

lead a contract to be void, voidable or unenforceable, to be an issue of validity and subject to interpretation by domestic law, not CISG interpretation.<sup>261</sup>

The potential for conflict between the domestic and international legal orders is especially great where the domestic rules in question concern issues, such as validity, so vital to the domestic legal order that they are excepted from the realm of contractual freedom.<sup>262</sup>

Article 4(a) poses a particular danger to the development of a coherent jurisprudence of international trade, because it gives adjudicators wide discretion to determine when to apply domestic law rather than the CISG to contracts for the international sale of goods.<sup>263</sup>

Article 4(a) of the CISG specifically states that the rules of contract validity, that is, whether the contract is valid at the outset, will be determined by the domestic law that the parties specified or that otherwise governs the contract.

(4) This Convention governs only the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract. In particular, except as otherwise expressly provided in this Convention, it is not concerned with:

(a) the validity of the contract or of any of its provisions or of any usage.<sup>264</sup>

Under the CISG, the validity of an alleged contract is decided under domestic law. By validity, CISG refers to any issue by which the “domestic law would render the contract void, voidable, or unenforceable.”<sup>265</sup> The effect of this provision, though not entirely settled by the courts, appears to be that the consideration requirement in common law jurisdictions remains alive and well even under CISG contracts when enforced in common law courts.<sup>266</sup>

Accordingly, if the applicable local law is common law, the validity of the contract would be largely dependent upon the rules set forth in the common law, including the doctrine of consideration. In the example given in the previous paragraph, we might conclude that warranties given by one party without any bargained-for-exchange with the other party would be unenforceable for lack of consideration if the contract formation were governed by common law rules.

In the case below, the parties to the supply contract are both based in countries that are parties to the CISG—the United States and Canada. These are also both common law countries. Thus, even though the CISG has no

---

the Convention on Contracts for the International Sale of Goods, 18 Yale J. Int'l L. 1, 3 (1993).

261. CISG Arts. 18-19.

262. Helen Elizabeth Hartnell, *Rousing the Sleeping Dog: The Validity Exception to the Convention on Contracts for the International Sale of Goods*, 18 YALE J. INT'L L. 1, 3 (1993).

263. *Id.* at 6.

264. CISG Art. 4(a).

265. Geneva Pharm. Tech. Corp. v. Barr Labs., Inc., 201 F. Supp. 2d 236, 282-83 (S.D.N.Y. 2002), *aff'd* in part, & *rev'd* in part, 386 F.3d 485 (2d Cir. 2004) (internal quotations omitted).

266. Barbara Berry, S.A. de C.V., v. Ken M. Spooner Farms, Inc., 2006 U.S. Dist. LEXIS 31262, at \*3-4 (W.D. Wash. Apr. 13, 2006).

consideration requirement, following rule 4(a) of that treaty requires a court, in assessing the validity of a contract, to apply local law.<sup>267</sup>

What should happen when a supply firm sends a letter of support to a manufacturer indicating that it is able to supply a needed element in the manufacturer's fabrication process and that manufacturer uses that letter to solicit governmental approval for their production? In the *Geneva Pharmaceuticals* case from 2002, a Canadian chemical supplier, ACIC, was to provide a chemical that would be used in the manufacture of an anti-coagulant drug by Geneva Pharmaceuticals, a U.S. pharmaceutical company.<sup>268</sup> In order for Geneva to receive governmental approval for the manufacture of this drug, it needed to present a letter from a supplier explaining availability of the chemical and security of their manufacture process.<sup>269</sup> ACIC provided this letter to Geneva.<sup>270</sup> The U.S. Food and Drug Administration (FDA) subsequently approved the drug and Geneva placed orders with ACIC for the needed chemical.<sup>271</sup>

Some time after the FDA granted approval and Geneva placed a large order from ACIC, the supplier refused to send the chemical, claiming that Geneva monopolized the market and prevented ACIC from acquiring other customers.<sup>272</sup> Geneva filed suit in New York against ACIC claiming, among other things, breach of contract.<sup>273</sup> As one of its defenses, ACIC argued that there was no valid contract because they never provided any valuable consideration to Geneva.<sup>274</sup>

The District Court in *Geneva Pharmaceuticals* explained that the CISG takes a very liberal approach to contract formation, allowing contracts to be formed "by a document, oral representations, conduct, or some combination of the three."<sup>275</sup> However, the court also reiterated that the CISG left certain issues to the courts to decide, stating "While embodying a liberal approach, the CISG does not vitiate the need to prove concepts familiar to the common law, including offer, acceptance, validity and performance."<sup>276</sup> This reaffirmed the implicit requirement within the CISG in cases involving a common law party in a common law court.

---

267. CISG art. 4(a).

268. *Geneva Pharm. Tech. Corp. v. Barr Labs., Inc.*, 201 F. Supp. 2d at 247-48.

269. *Id.* at 247.

270. *Id.* at 248.,

271. *Id.* at 249.

272. *Id.* at 261. *Geneva Pharm. Tech. Corp. v. Barr Labs., Inc.*, 386 F.3d 485, 493 (2d Cir. 2004).

273. *Id.*

274. *Id.*

275. *Geneva Pharm. Tech. Corp. v. Barr Labs., Inc.*, 386 F.3d at 493.

276. *Id.*

On this basis, and citing to a number of similar federal cases, the court found sufficient consideration to form a valid contract under common law rules.<sup>277</sup> The judge reiterated the fact that consideration need not be equal on both sides of a transaction.<sup>278</sup> In this case, the court fashioned an implied-in-fact contract, a contract established by the circumstances of a transaction rather than via a clear contractual agreement. The valuable consideration here was the American company's reliance on the Canadian company's letter, which prompted the American company to submit their FDA application and effectively guaranteed the supplier a customer for its *Clathrate*.<sup>279</sup> The court found this to be reasonable inducement by the supplier, which the buyer relied upon.<sup>280</sup>

The *Geneva Pharmaceuticals* case is a prime example of how consideration remains a concern for common law parties under the CISG when there exists a question of contract validity and a common law court is answering that question.<sup>281</sup> It also reflects on the deference given to the court interpreting the validity of the contract. A common law court infrequently examines the adequacy (amount) of consideration between the parties; however, it does require that some sufficient (legal value) consideration exist to form a valid contract. Sufficient consideration, despite its inadequacy, was found here and thus the contract was upheld as validly formed.

In the *Shuttle Packaging Systems* case, the court addressed whether a party has to provide additional consideration in order to add a new requirement under an existing contract that was validly formed.<sup>282</sup> The case involved a Greek seller and a U.S. buyer of plastic gardening products. The contract originally included a non-compete agreement, but it did not lay out the terms and stated instead that they would be established in a subsequent agreement. When the non-compete agreement was later entered into, the buyer objected to the scope of the non-compete clause. The contract specified that the non-compete clause would be governed under the law of Michigan (the overall contract was governed by the CISG). The buyer asserted that the clause, which was a contract "modification," was invalid for lack of consideration. The court concluded that CISG Article 29 allowed modifications without consideration and, although local law established in the contract governs the interpretation of the clause, the CISG governs its validity under Article 29 since it is a modification and not a new contract.

---

277. *Geneva Pharm. Tech. Corp. v. Barr Labs., Inc.*, 201 F. Supp. 2d at 284.

278. *Id.* at 283.

279. *Id.*

280. *Id.*

281. *See, e.g.*, Lutz, *supra* note 216, at 721–22 (3/2004) (calling the article 4(a) exception a "black hole").

282. *Shuttle Packaging Sys. v. Tsonakis*, 2001 U.S. Dist. LEXIS 21630 (W.D. Mich. Dec. 17, 2001).

Whether a contract modification like the one considered in the *Shuttle Packaging Systems* case will be enforced without consideration depends on whether the contract is governed by the CISG or by common law principles.<sup>283</sup> In the civil law, an agreement between the parties to modify the contract is effective if there is sufficient *causa* even if the modification relates to the obligations of only one of the parties. In the common law, however, a modification of the obligations of only one of the parties is, in principle, unenforceable because new “consideration” is lacking. Many of the modifications envisaged by Article 29 of the CISG are technical modifications in specifications, delivery dates, or the like, which frequently arise in the course of performance of commercial contracts. Even if such modifications to the contract may increase the costs of one party, or decrease the value of the contract to the other, the parties may agree that there will be no change in the price. Such agreements, according to article 27(1) [*draft counterpart of CISG article 29(1)*], are effective, thereby overcoming the common law rule that “consideration” is required.”<sup>284</sup>

The *2P Commercial Agency* case is indicative of the oft-difficult position that common law courts are placed in when navigating common law consideration rules applied to a contract governed by the CISG.<sup>285</sup> In this 2013 case, SRT USA offered to sell 2P 400 iPhones via an executed purchase order.<sup>286</sup> 2P made an initial deposit into SRT’s bank account for \$55,360.<sup>287</sup> Between that point and the start of this lawsuit, Len Familiant, the initial sales consultant from SRT, made a personal guarantee to 2P in the amount of \$300,000 should SRT fail to deliver the goods.<sup>288</sup> The goods were never delivered, and 2P sued both SRT for breach of goods contract and Familiant for breach of guarantee.<sup>289</sup>

Though the CISG clearly governed this contract dispute, the relevant issue for discussion was one of consideration.<sup>290</sup> The personal guarantee by Familiant was made after the initial contract was executed, so the question became whether this guarantee was a modification to the original sales contract, in which case it would be governed by and permissible under CISG Article 29, or whether it was a new agreement altogether, in which case it would be a question

---

283. *Id.*

284. *Secretariat Commentary, Guide to CISG Article 29*, PACE L. SCH. INT’L & COM L. (last updated Aug. 29, 2006), <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-29.html>.

285. *2P Commercial Agency S.R.O. v. SRT United States*, No. 2:11-cv-652-FtM-29SPC, 2013 U.S. Dist. LEXIS 9186 (M.D. Fla. Jan. 23, 2013).

286. *Id.* at \*1.

287. *Id.*

288. *Id.*

289. *Id.*

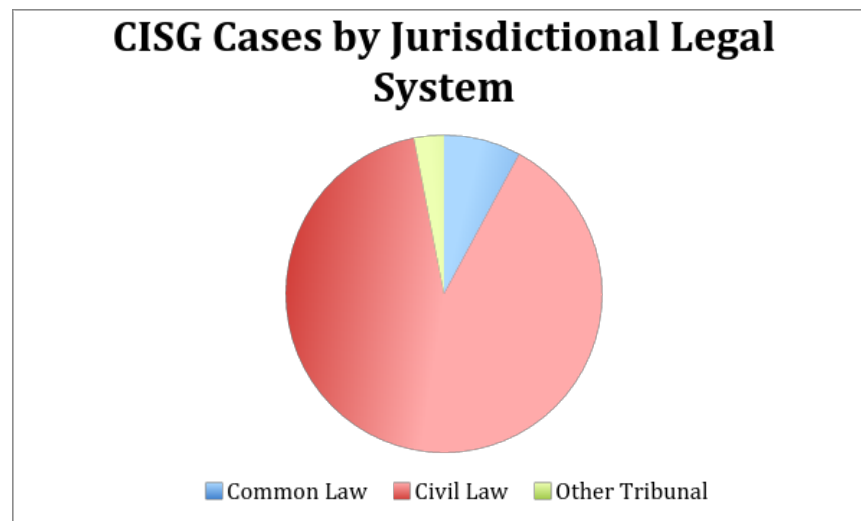
290. *Id.* at \*5.



of contract validity governed by Article 4(a).<sup>291</sup> The court ultimately concluded that this was a question that needed additional argument and consequently denied the plaintiff's motion for summary judgment.<sup>292</sup> The outcome of this case was not known as of the time of this writing.

The cases that are mentioned in this Section are rare in that they involve contracts governed by the CISG and heard in common law courts.<sup>293</sup> The vast majority of cases heard by courts that apply CISG rules are found in countries that apply civil law. As the chart below shows, less than ten percent of the total CISG cases worldwide have been tried in common law jurisdictions where Article 4(a) might lead a tribunal to address the issue of consideration. This trend suggests that parties to international sales contracts from common law countries either opt-out of the CISG altogether in favor of some other choice of law (which is often advised by counsel in the United States) or they have included binding commercial arbitration clauses, which may or may not have applied the CISG rules,<sup>294</sup> but which are generally disputed privately.

**Figure 1. CISG Cases by Jurisdiction (2014).**



\* Current as of September 2014. Source: Pace Law School CISG Database and Author's calculations.

291. *Id.* at \*6.

292. *Id.*

293. *See, e.g.,* Lutz, *supra* note 216, at 714 (finding that out of 1,265 CISG cases, only 56 were decided by U.S. courts).

294. *See, e.g.,* Nils Schmidt-Ahrendts, *CISG and Arbitration*, 3 BELGRADE L. REV. 211 (2011).

## V.

## ATTEMPTED SOLUTIONS TO THE CONSIDERATION PROBLEM

As can be seen from the foregoing cases and discussion, consideration is a potential requirement for contracts between parties in civil and common law jurisdictions, but it is not always clear whether it will be a bar to establishing contract validity. This uncertainty has led many parties to take preemptive steps to avoid having their contract fail for lack of consideration. This Section examines the most common of these approaches—the consideration recital. Recitals are statements made, usually in the preliminary clauses of the contract, asserting generally agreed upon principles between the parties. These statements do not create obligations or give rights to any party; rather, they are meant to assert facts to which the parties have agreed. Below is an example of a consideration recital:

In consideration of the promises and the mutual covenants set forth herein and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree as follows.

A clause like this appears in many corporate contracts as boilerplate language. However, the clause alone does not overcome the problem of consideration.<sup>295</sup> In the event that a court finds that a contract lacks valid consideration, the inclusion of a consideration recital will have no effect on the validation of that contract in a common law jurisdiction. Consideration is found by examining the promises and acts of the parties to the contract, not in the statement of a recital.

The problem is that a recital of consideration fails to show the existence of sufficient legal consideration. Courts have consistently held that the “mere recital of consideration, which is one of the weakest elements to be found in any written contract, to be weighed against the granting and descriptive clauses, which, to say the least, are of vital importance in any instrument.”<sup>296</sup> Yet the boilerplate inclusion of this recital provides contracting parties with false confidence that additional actions confirming the bargained for exchange are unnecessary.

A recent example of the failure of boilerplate language to constitute valid consideration occurs in *Yessenow*, where an Indiana federal court invalidated a

---

295. See, e.g., Kenneth Adams, *Drafting a New Day: Who Needs that “Recital of Consideration”?*, BUS. L. TODAY, Mar./Apr. 2003, at 2 (“the traditional recital of consideration will in most contracts be ineffective to remedy a lack of consideration. . . .”).

296. *McCann v. Glynn Lumber Co.*, 34 S.E.2d 839, 844 (Ga. 1945); see, e.g., *Smith v. Nationwide Mut. Ins. Co.*, 546 N.Y.S.2d 522, 523 (Sup. Ct. 1989) (finding that receipt of consideration in addition to a recital is necessary for contract validity); see also *Socko v. Mid-Atl. Sys. of CPA, Inc.*, 99 A.3d 928, 932 (Pa. Super. Ct. 2014) (explaining the need for valuable and not merely nominal consideration); Adams, *supra* note 256; Joseph Siprut, *Comments: The Peppercorn Reconsidered: Why a Promise to Sell Blackacre for Nominal Consideration is not Binding, but Should be*, 97 N.W. U. L. REV. 1809, 1823-24 (2003); RESTATEMENT (SECOND) OF CONTRACTS 79 cmt. c (AM. LAW INST. 1979).

\$1.5 million indemnity contract because it lacked valuable consideration.<sup>297</sup> The case involved two doctors who invested in a hospital that later went bankrupt. One doctor, Yessenow, vouched for the debts of the hospital and secured his guarantee by offering his Chicago condo as collateral. Subsequently, he sought to protect against his risk by securing an indemnity agreement from another doctor, Hudson. The indemnity agreement relied upon the following language in their contract: “[f]or good and valuable consideration, the parties hereto, intending to be legally bound, hereby agree as follows.”<sup>298</sup>

After the hospital went bankrupt and sought to foreclose on Yessenow’s condo, Yessenow turned to Hudson for indemnification. Hudson refused. Yessenow sued and the court made it eminently clear that a mere recital of consideration will not suffice to support a valid contract, stating “it is also black-letter contract law that a ‘false recital of consideration’ is ‘a mere pretense of bargain [that] does not suffice’ to create a contract.”<sup>299</sup> The court continued: “[i]f merely saying in writing that a specified fictitious consideration had been received were enough to make a promise binding, a new kind of formal obligation would be created.”<sup>300</sup>

It should be noted that some states have dispensed with the requirement of consideration for certain contracts.<sup>301</sup> A prominent recent example is the state of Pennsylvania, which, through its Uniform Written Obligations Act allows an agreement to form a binding and valid contract if it is signed and the parties clearly evidence their intent to be bound by its terms.

[A] written release or promise, hereafter made and signed by the person releasing or promising, shall not be invalid or unenforceable for lack of consideration, if the writing also contains an additional express statement, in any form of language, that the signer intends to be legally bound.<sup>302</sup>

This closely tracks the current civil law approach to contract validity and, while not widespread, is evidence that frustration over the consideration doctrine permeates common law jurisdictions.<sup>303</sup> Note that Utah had also adopted this Act but later repealed it, making Pennsylvania the only state that applies it.<sup>304</sup>

297. *Yessenow v. Hudson*, No. 2:08-CV-353 PPS, 2012 U.S. Dist. LEXIS 101132, at \*10 (N.D. Ind. July 19, 2012).

298. *Id.* at \*3.

299. *Id.* at \*8, (citing RESTATEMENT (SECOND) OF CONTRACTS § 71, cmt. b (AM. LAW INST. 1981)); see also Kenneth Adams, *Drafting a New Day: Who Needs that “Recital of Consideration”?*, BUS. L. TODAY, March/April 2003, at 1 (“a recital cannot transform into valid consideration something that cannot be consideration.”).

300. RICHARD A. LORD, 3 WILLISTON ON CONTRACTS § 7:23 (4th ed. 2011).

301. The minority rule allows false recitals of consideration to support a contract that is otherwise valid. See *1464-Eight, Ltd. v. Joppich*, 154 S.W.3d 101, 110 (Tex. 2004) (recognizing that the decision to recognize a false recital of consideration is not the majority rule).

302. Pennsylvania Uniform Written Obligations Act, 33 PA. CONS. STAT. § 6 (1927).

303. *Socko v. Mid-Atl. Sys. of CPA, Inc.*, 99 A.3d 928, 932 (Pa. Super. Ct. 2014).

304. See James D. Gordon, *supra* note 6, at 311.

## VI.

## AVOIDING THE CONSIDERATION PROBLEM IN COMMERCIAL CONTRACTS

The intention of this Article is not only to highlight the distinctions between contract formation and enforcement in common and civil law jurisdictions, but to provide practical guidance in order to avoid an enforcement problem based upon faulty consideration. To do that this final Section begins with a set of general technical recommendations, and then suggests specific language to include in both contracts and contract modifications, to effectively counter consideration challenges.

Parties to a contract that have selected a common law jurisdiction for enforcement will have to show valuable consideration to establish the validity of their contract. This is true whether the contract is governed purely by the common law (i.e., real property, services), by the UCC, or by the CISG if common law validity principles are applied. To reiterate, the common law requires consideration, the UCC has not dispensed with this requirement, and common law courts applying CISG principles have tended to interpret Article 4(a) as requiring them to apply local law to determine the validity of the contract, including the requirement of consideration. Accordingly, unless a contract is being exclusively formed and enforced in civil law jurisdictions, parties would be wise not to ignore the doctrine of consideration.

Although some commentators argue that consideration is an unnecessary and archaic doctrine, it remains central to the enforceability of contracts in common law courts. “There is no socially useful reason for a legal system to enforce agreements that are not supported by consideration.”<sup>305</sup> Parties that choose to ignore it in their contracts do so at the risk of non-enforcement in a common law jurisdiction.

The key to overcoming a consideration challenge is to show that the parties bargained for their exchange. This is not as easy as it sounds. For instance, as discussed in the previous Section, a simple recital in a contract attesting to the existence of valuable consideration will usually not survive scrutiny by a common law court. The parties must be able to prove that entry into the agreement was induced by the actions or promises of the other party and this must be made clear by the language of the contract.

*A. General Recommendations*

This Section begins with a set of general recommendations for overcoming the risk of non-enforcement due to lack of consideration in a common law jurisdiction. These are suggestions based upon specific common law court decisions that questioned the nature of the consideration provided by the parties. Each of these points should be contemplated when drafting the initial contract:

---

305. Yessenow v. Hudson, 2012 WL 2990643, at \*10.

1. Include evidence of the receipt of consideration when relying on a consideration recital to prove the bargain. As discussed above, consideration recitals, while they may substantive and clearly state the obligations of the parties to the agreement, may also be superficial and meaningless. If a recital is used, ensure that it clearly identifies the basis for the consideration on the part of both parties.
2. Do not commit as valuable consideration assets that have already been committed elsewhere and that may not be available during the performance of the contract under negotiation. When the object of consideration is committed elsewhere, it cannot serve as valuable consideration in a subsequent contract since it may not actually exist at the time of contract execution. Only commit assets that are or will be available during the performance period of the contract.
3. Avoid nominal consideration. Though a peppercorn may serve as valuable consideration in a commercial contract, a court will be highly skeptical of the agreement, especially if the peppercorn (or other nominal consideration) is not actually transferred. Though a court will not generally evaluate the adequacy (amount) of consideration in a contract, they will look to party intent to assess whether the parties undertook any true risk. If the parties have not agreed upon the specifics of the consideration at the time of contract formation but intend to do so during the performance period, the contract can include the following language: "For good and valuable consideration, the sufficiency and receipt of which is hereby acknowledged, the parties agree as follows. . ." Bear in mind that if consideration is challenged under a provision such as this, the parties will indeed have to prove that such consideration existed and was exchanged.
4. Make the bargained-for-exchange aspect of the consideration conspicuous in the contract. A contract should be entered into by an offeree on the basis of an offer from the offeror, and vice versa. The formation of a contract depends on the inducement of the other party and this should be reflected in the consideration exchanged by the parties. Language in the contract recital or clause can easily reflect this: "Party A shall provide Party B with money *in exchange for* Party B's promise to perform X service." The italicized language makes clear that the contract is *quid pro quo* and that the basis of Party A's performance is the promise of Party B, and vice versa.

### B. The Consideration Clause

Now that we understand the weaknesses of the consideration recital, we can evaluate an alternative approach—the consideration clause. A contract clause within the core provisions of the contract goes much further than a recital and specifically identifies not only the existence of consideration, but also how it

was bargained for. There may still be doubts as to whether the consideration was exchanged at all, but this clause provides evidence that the parties understood the nature of the consideration and that they were induced by the promise of the other when agreeing to the contract. This is known as the consideration clause.

Before delving deeper into the consideration recital and clause, it is important to note that the lack of either in a contract does not seal its fate as unenforceable in a common law court. Several courts have concluded that consideration can be implied from other terms of the contract or from the actions of the parties. One court noted, “a finding of consideration does not depend on the existence of a consideration clause or a money payment.”<sup>306</sup> However, as the cases cited throughout this Article have shown, the surest way to avoid a consideration challenge is to include express language in the contract attesting to the nature of the exchange.

Commercial contracts in the common law, unlike the civil law, are about taking risks and creating expectations. When a party makes an offer to another party, that offer may induce acceptance by the offeree, at which point a contract may have been formed. At that moment, both the offeror and the offeree have taken on a new risk—a risk that their bargain will not give them what they hoped for. If Party A offers to sell his racehorse to Party B for \$5,000, he risks receiving less than the true value of the horse (or that the value of the horse increases after the sale). If Party B accepts, he risks paying more than the true value of the horse (or that the value will diminish after the sale). Because both parties are taking a risk in the contract formation process, we can easily identify valuable consideration.

To be sure that a commercial contract is enforceable in the common law context, evaluate whether both parties have taken on a real risk by agreeing to the terms of the contract. Spell this risk out as clearly as possible in a consideration clause, not merely a recital. The difference between a consideration recital and a consideration clause is in the obligation created. Recitals are intended to assert statements of fact about the parties of the transaction. They are often used to provide background to the agreement—what led the parties to the negotiating table in the first place. A consideration recital might look like this:

Jones owns a factory located at 100 Maple Leaf Drive and wishes to sell that factory and all of its operating assets to Smith, who has concluded a Deposit Agreement with Jones (Exhibit A) providing good and valuable consideration for this purchase.

The language appears to suggest that Jones bargained for the money identified in the Deposit Agreement by offering to sell Smith his factory, and

---

306. *Lake Cable v. Trittler*, 914 S.W.2d 431, 434 (Mo. Ct. App. 1996) (finding that the parties bargained for the right of first refusal, which limits the actions of the other party and thus creates sufficient consideration); *see also* *McRentals, Inc. v. Barber*, 62 S.W.3d 684, 706 (Mo. Ct. App. 2001) (finding implied promises valid to support an employment and stock option agreement).

that may very well be the case. However, unlike a core contract clause or even a representation, recitals are not actionable in the event of breach because they provide no obligation to perform, and thus no remedy in the event of non-performance. “When the recital of consideration merely acknowledges the receipt of a fixed sum, such recital is generally considered to be merely a noncontractual receipt.”<sup>307</sup>

The recitals are meant to provide the court with evidence of intent to enter the contract. These are undoubtedly helpful in overcoming a challenge to the consideration in a contract, but they may be insufficient to show that the parties bound themselves to each other through bargained-for obligations, which would only appear in the body of the contract.

A consideration clause, on the other hand, should focus on the nature of the exchange between the parties—who is paying, how much are they paying, what are they paying for, and who is giving them something in return. It should apply language of mutual obligation and make clear that the parties are entering the contract based upon the commitments of the other. A consideration clause in an employment contract might look like this:

In exchange for A’s valuable services as a sous chef at B’s restaurant, B hereby agrees to compensate A in the amount of \$100,000 annually, which B shall provide to A in monthly installments on the last calendar day of each month.

In a goods contract, the phrasing would be slightly different:

A shall pay B \$10,000 as good and valuable consideration in exchange for B’s promise to deliver 100 blue widgets, which shall conform to the specifications outlined in Exhibit 1 of this contract.

The use of the “shall” term signifies an obligation, making this an enforceable clause should a dispute arise. However, it is wise to limit the scope of the consideration clause to only the value being exchanged and to leave specifics about timing, delivery, and other specifications to other sections of the contract dedicated to these matters. Including such detail here runs the risk of creating overlapping obligations with potentially distinct requirements.<sup>308</sup>

### C. Contract Modifications

It is fair to say, however, that consideration is more of a concern for parties when they are drafting their initial contract than after they have begun performance under that contract. But it is still very important to reiterate the role of consideration in making contract modifications. As discussed earlier, the preexisting duty rule prevents a contract modification from being enforced in a common law contract. Thus, when A has contracted with B to perform a valuable service and B proposes a change in terms (e.g., price) due to changed

---

307. 29A AM. JUR. 2D, *Evidence* § 1141, Westlaw (2016).

308. But see Tina L. Stark, *Drafting the Consideration Provision of a Contract*, 51 THE PRACTICAL LAW 11, 12 (2005) (suggesting that the consideration clause should include adequate detail to identify the means, method, and conditions for payment).

circumstances, a common law court would be unlikely to permit that modification based upon the preexisting duty of B to perform his original obligations. We also know that this rule does not apply to UCC or CISG contracts. But even within the common law, how much of a problem does this pose?

A 1992 survey of businesses inquired about their willingness to allow contract modifications without additional consideration.<sup>309</sup> In that survey, ninety-five percent of respondents replied that they would not insist on strict compliance with the terms of the contract in the face of a proposed modification.<sup>310</sup> Most respondents stated that they would accept modifications if they were reasonable under trade practice or if they were interested in maintaining long-term positive relations with the requesting party.<sup>311</sup>

The Restatement (Second) of Contracts states that a contract modification is not valid if one party merely performs what he has already obligated himself to do.<sup>312</sup> This is the preexisting duty rule. However, the Restatement leaves room for modifications unsupported by new consideration in cases in which the parties face an unanticipated change in circumstances and act in good faith to adapt the contract accordingly.<sup>313</sup> The basis for this requirement is found in the court's fear that a party could be persuaded to give more than they bargained for by a party trying to exploit a situation.

[T]here is often an interval in the life of a contract during which one party is at the mercy of the other. A may have ordered a machine from B that A wants to place in operation on a given date [and] may have made commitments to his customers that it would be costly to renege on. As the date of scheduled delivery approaches, B may be tempted to demand that A agree to renegotiate the contract price, knowing that A will incur heavy expenses if B fails to deliver on time. A can always refuse to renegotiate, relying instead on his right to sue B for breach of contract if B fails to make delivery by the agreed date. But legal remedies are always costly and uncertain.<sup>314</sup>

This language from Judge Cardozo is particularly enlightening of the practical effect of the common law's prohibition on contract modifications without new consideration. A party is often better off accepting the "new" agreement, which undoubtedly reduces the welfare of the party preferring the original terms, rather than confronting the other party in court and paying the

---

309. Russell J. Weintraub, *A Survey of Contract Practice and Policy*, 1992 WISC. L. REV. 1, 18 (1992).

310. *Id.* at 17.

311. *Id.* at 18.

312. RESTATEMENT (SECOND) OF CONTRACTS § 86 (AM. LAW INST. 1981).

313. *Id.* at § 89(a); see also Robert A. Hillman, *Contract Modification Under the Restatement (Second) of Contracts*, 67 CORNELL L. REV. 680, 692 (1982).

314. *United States v. Stump Home Specialties, Inc.*, 905 F.2d 1117, 1121–22 (7th Cir. 1990).



associated costs.<sup>315</sup> This is likely part of the reason that so many businesses accept modifications so willingly.

This leaves two practical questions. First, how can parties prevent contract modifications without new consideration? And second, how can parties successfully modify an existing contract? I will address these briefly below.

Many parties are aware that contracts may sometimes be modified, explicitly or implicitly, by the conduct of the parties. Failing to enforce a particular right within a contract, for instance, may result in the party waiving its ability to enforce that right in the future and thereby implicitly modifying the contract. Alternatively, parties may agree expressly to divert from an obligation within the contract, temporarily or for the remaining term, without adding new consideration. Both of these situations pose risks to the parties that they will not receive the benefit of their original bargain.

Accordingly, a number of contracts today include both “no oral modification” clauses as well as “no waiver” clauses. The clauses look like this:

No waiver of satisfaction of a condition or nonperformance of an obligation under this agreement will be effective unless it is in writing and signed by the party granting the waiver.

Clauses that require any contract modification to be in writing have been dismissed in cases where the actions of the parties show assent to a verbal modification.<sup>316</sup> “No waiver” clauses have been more successful in blocking modifications without new consideration. However, even in cases in which both “no oral modification” and “no waiver” clauses appear in a contract, courts have found ways to ignore them based upon the party’s apparent intent and actions.<sup>317</sup>

The next question is how to successfully modify an existing written contract, even where the contract attempts to prevent changes. This was the issue in the *Green v. Millman Bros, Inc.* case, in which a landlord and tenant orally agreed to modify the amount to be charged for rent each month.<sup>318</sup> Their actions demonstrated acceptance of this modification. However, they ultimately disagreed about how long this modified rental amount would be permitted. When the landlord sued for the original amount, he claimed that the modification lacked consideration. The tenant contended that his willingness to

---

315. Christine Jolls, *Contracts as Bilateral Commitments: A New Perspective on Contract Modification*, 26 J.L. STUD. 203, 218-21 (1997).

316. LUCY D. ARNOLD, FULBRIGHT & JAWORSKI LLP, I DIDN’T SAY THAT!: “NO ORAL MODIFICATION” CLAUSES IN ENERGY TRANSACTIONS (2011).

317. See, e.g., Salma S. Safiedine, Mary Clarke, and Amanda Galbo, *Oral Modifications Notwithstanding a No Oral Modification Clause: Preserving the Right to Contract or Enabling Havoc?*, AM. BAR ASS’N: WHITE COLLAR CRIME COMM. NEWSLETTER, Fall 2014, at 2, [http://www.americanbar.org/content/dam/aba/publications/criminaljustice/wcc\\_newsletter\\_fall14\\_or\\_al\\_mod.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publications/criminaljustice/wcc_newsletter_fall14_or_al_mod.authcheckdam.pdf) (“parties to a contract are free mutually to waive or modify their agreement through written and oral agreements, as well as through conduct, notwithstanding the presence of [preventive clauses] purporting to restrict that ability.”).

318. 7 Mich. App. 450 (1967).

continue the rental was what bargained in exchange for the reduced rental amount. The court disagreed. It stated that “[t]he general rule [for consideration] is that a promise to do that which the promisor is legally bound to do, or the performance of an existing legal obligation, does not constitute consideration, or sufficient consideration, for a contract.”<sup>319</sup> The tenant was already obligated to continue the rental under the original contract, so he had given no new consideration for the modification. Accordingly, the modification was invalid for lack of consideration.

What we learn from these cases is that preventing contract modifications through preventive clauses is not a foolproof mechanism. If we want to permit such modifications in an existing contract, we will have to identify additional consideration not present in the original contract. This additional consideration could be as simple as adjusting the overall cost of the contract in exchange for an earlier or later delivery date, taking on an additional task for an additional benefit, or adjusting the quality of materials in exchange for a higher cost. Whatever the modification, some bargained-for benefit must be provided by the party seeking the modification to withstand challenge later on.

With these recommendations in mind, a party drafting a contract or modifying a contract subject to common law rules can do so more confidently knowing that it will withstand a consideration challenge. Including a recital, as well as covenants, attesting to the risks that the parties took on in agreeing to the terms of the contract provide the best defense to a consideration challenge in a common law court.

## CONCLUSION

The potential conflict that may ensue between parties to cross-border transactions involving both civil and common law jurisdictions for purposes of contract interpretation is significant. Ignoring the element of consideration in a contract that has any possible linkage to a common law jurisdiction is dangerous and may result in the contract being unenforceable in common law courts. Yet as discussed in the previous Section, including appropriate language identifying the consideration is not a heavy burden for the drafting party from any jurisdiction.

Since its inception in the seventeenth century, consideration has stood for the proposition that a contract can only be enforced if both parties made their agreement on the basis of mutual benefit. It provides the justification for the parties to agree to the bargain. Over time, courts have occasionally sought to turn consideration into a formality that might be dispensed with under certain conditions.<sup>320</sup> However, “requiring mutual inducement means that the law

---

319. *Green v. Millman Brothers, Inc.*, 151 N.W.2d 860, 863 (Mich. Ct. App. 1967).

320. See, e.g., James D. Gordon III, *A Dialogue About the Doctrine of Consideration*, 75 CORNELL L. REV. 986 (1990); Wessman, *supra* note 194, at 731.

favors beneficial transactions.”<sup>321</sup> As discussed, at least one common law jurisdiction, Pennsylvania, has already dispensed with the requirement of consideration and allows statements of intent to suffice as a substitute.<sup>322</sup> Also, some non-U.S. common law jurisdictions, such as Singapore, have explicitly recognized that a contract lacking consideration may be upheld as valid and enforceable under conflict of laws rules.<sup>323</sup>

In commercial contracts, the Article contends that consideration continues to serve a valuable purpose. Gratuitous promises, while undoubtedly an important part of doing business, must not be construed and enforced as binding contracts because they create unilateral benefits and unilateral obligations on either side of the same transaction, calling into question the mutuality of the obligation. This lack of mutuality removes the motivation that binds parties to a valid contract—namely, risk. A party enters a contract on the basis of risk, expecting a return on that risk upon completion of performance. Without risk, a party cannot rely upon the enforcement provisions inherent to contract law, nor can they pursue their expectation interest should the other party breach. The resulting uncertainty weakens the value of binding yourself to a contract in the first place.

In today’s rapidly globalizing business environment, firms are increasingly entering contracts involving parties in both common and civil law countries. This trend will likely continue, especially as barriers to cross-border trade fall as a result of trade agreements that reduce tariff and non-tariff barriers to trade.<sup>324</sup> Private parties are not protected under these agreements with respect to enforcement of purely private contracts and due consideration should be paid to the development of written agreements that will be enforceable in both common and civil law jurisdictions.

Accordingly, this Article cautions parties to contracts that may have their formation judged by a common law court to take seriously the doctrine of consideration. Failure to properly account for mutuality both within the terms and the performance of the contract risks the very validity of the contract. A small investment of time spent on this element at the outset of the drafting process can substantially strengthen the likelihood of enforcement in the future.

321. Val Ricks, *Consideration and the Formation Defenses*, 62 KAN. L. REV. 315, 339 (2013).

322. See, e.g., Pennsylvania Uniform Written Obligations Act, 33 PA. CONS. STAT. § 6 (1927).

323. The Conflict of Laws: Choice of Law § 6.3.6, (2015) (Sing.) <http://www.singaporelaw.sg/sglaw/laws-of-singapore/overview/chapter-6> (“in domestic Singapore law, the doctrine of consideration is an essential ingredient of a contract not made under deed. Nevertheless, an agreement not supported by consideration can be characterised as a “contract” for choice of law purposes, in recognition that other legal systems do not use consideration to resolve the problems that the common law uses that doctrine to resolve (Re Bonacina [1912] 2 Ch 394).”).

324. Consider, for example, the Trans-Pacific Partnership, signed in February 2016. See, e.g., Tim Worstall, Opinion, *The TPP, World’s Largest Trade Pact, Finally Gets Signed*, FORBES (Feb. 4, 2016), <http://www.forbes.com/sites/timworstall/2016/02/04/the-tpp-worlds-largest-trade-pact-finally-gets-signed/#3a2adbc24062>.

# South Africa And The Human Right To Water: Equity, Ecology, And The Public Trust Doctrine

David Takacs\*

## ABSTRACT

After liberation from apartheid in 1996, South Africa's new, progressive Constitution proclaimed: "Everyone has the right to have access to sufficient food and water." In this paper, I analyze South Africa's revolutionary legal vision for marrying social equity to ecology in fulfilling the right to water. South Africa's successes and obstacles as a developing nation with few natural water sources and great water needs demonstrates the translation of aspirational ideas into functional law. This is significant not just to South Africa's own citizens, but extends to the entire world. South Africa's approach contains essential lessons for how to use the law to support the billion plus people around the world whose right to water remains unfulfilled, and to the million plus people who die each year from dehydration or diseases related to unclean or inadequate water supplies. South Africa's past and future approaches to implementing the right to water will continue to shape the legal meanings of "progressive realization" within "available resources" for all economic, social and cultural human rights worldwide.

I first examine South Africa's initial, visionary laws and policies which sought to implement the human right to water. South Africa's legal blueprint resurrected its Public Trust Doctrine, requiring the government to protect the ecological "Reserve" that nourishes the right to water. After promising

---

DOI: <http://dx.doi.org/10.15779/Z388261>

\* Professor of Law, University of California Hastings College of the Law, and Stellenbosch Institute for Advanced Study; J.D., UC Hastings; LL.M., School of Oriental and African Studies, University of London; Ph.D., Cornell University, Science & Technology Studies; M.A., Cornell University, History and Philosophy of Science; B.S., Cornell University, Biological Sciences. The author wishes to thank Patrick Andrews, Michael Blumm, Mark Botha, Larry Carbone, John Dini, Jackie Dugard, Loretta Feris, Chimène Keitner Louis Kotzé, Al Lin, Peter Lukey, Jeffrey Manuel, Nora Mardirossian, Dave Owen, Naomi Roht-Arriaza, Oliver Ruppel, Buzz Thompson, & Jessica Wilson for valuable intellectual contributions. Thanks also to the excellent editorial work of the *BJIL* students! This work was supported by a generous Fellowship from the Stellenbosch Institute for Advanced Study, <http://stias.ac.za>, Wallenberg Research Centre at Stellenbosch University, Marais Street, Stellenbosch 7600, South Africa.

beginnings, South Africa applied legally questionable policies vis-à-vis the right to water. For example, it considered the equivalent of two toilet flushes per person per day as an adequate supply of water. Furthermore, it allowed government water service providers to install prepaid water meters for the poorest of the poor, which shut off water supply without notice when water use exceeded the predetermined “adequate” supply.

These policies were upheld by the globally influential South African Constitutional Court in *Mazibuko v. City of Johannesburg*, which this Paper argues undermined the human right to water. The Court failed to respect constitutional prescriptions to advance equity. It also failed to consider public trust responsibilities to steward the legally mandated ecological Reserve, the ultimate source of water. The Court also misconstrued the Constitution’s command to “take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of” the right to water. Judges and bureaucrats alike—in South Africa and in too many other locales—fail to see that “available resources” must include ecological resources. Failure to root the human right to water in its ecological milieu is a failure to make progress in fulfilling the human right to water.

After leading the world in getting the right to water right and then wrong, South Africa has again formulated groundbreaking legal plans to realize the right to water. The nation seeks to reallocate water towards those in greatest need, and has established ambitious plans to steward the ecological Reserve that underlies the human right to water. If South Africa succeeds in implementing its new legal strategies based on the “indivisibility of water,” it will offer a blueprint for how to make the human right to water more than an empty promise through a reconfigured, visionary understanding of the Public Trust Doctrine that marries equity to ecology.

#### TABLE OF CONTENTS

INTRODUCTION .....	57
I. BACKGROUND .....	62
A. <i>The Right to Safe Clean Water</i> .....	62
B. <i>The Right to Water Mischaracterized</i> .....	64
C. <i>Progressive Realization, Progressive Loopholes</i> .....	65
D. <i>Economic, Social, and Cultural Rights Jurisprudence in South Africa</i> .....	67
E. <i>Background on the Right to Water in South Africa</i> .....	69
F. <i>Deep Equity and the Right to Water</i> .....	72
G. <i>Thinking about Environmental Problems</i> .....	72
II. SOUTH AFRICA AND THE PUBLIC TRUST DOCTRINE: MARRYING EQUITY TO ECOLOGY .....	74
A. <i>Introduction</i> .....	74

III. THE RESERVE .....	79
IV. MAZIBUKO V. CITY OF JOHANNESBURG: GOING TO COURT TO ADJUDICATE THE RIGHT TO WATER .....	82
A. <i>Introduction</i> .....	82
B. <i>Mazibuko Background</i> .....	83
C. <i>Mazibuko at the Trial Court: A Victory for the Right to Water</i> .....	84
D. <i>Mazibuko at the Constitutional Court</i> .....	86
E. <i>Progressive Realization and the Right to Water Redux</i> .....	90
V. GETTING THE RIGHT TO WATER RIGHT AGAIN .....	97
VI. "THE INDIVISIBILITY OF WATER": SOUTH AFRICA BACK ON THE DEEPLY EQUITABLE PATH .....	101
A. <i>Strategic Integrated Project 19: Ecological Infrastructure for Water Security</i> .....	104
CONCLUSION .....	107

## INTRODUCTION

Although we live on a water planet,<sup>1</sup> only one-one hundredth of one percent of all water on Earth is available in fresh, drinkable form.<sup>2</sup> According to the World Health Organization, over one billion people lack access to a basic supply of clean water, which is defined as fifty to one hundred liters per day within one kilometer of a residence.<sup>3</sup> Nearly half of all people in developing countries suffer from poor health related to inadequate or unclean water, and 3,600 people die each day (3.7 percent of total deaths and 15 percent of childhood deaths) from diseases stemming from unclean water and improper sanitation, more than from measles, malaria, and AIDS combined.<sup>4</sup> Water

---

1. NASA Global Climate Change, *Earth: The Water Planet*, YOUTUBE (Dec. 22, 2010), <https://www.youtube.com/watch?v=moSBExILu2M>.

2. Andrew L. Magaziner, *The Trickle Down Effect: The Phiri Water Rights Application and Evaluating, Understanding, and Enforcing the South African Constitutional Right to Water*, 33 N.C. J. OF INT'L L. & COM. REG. 509, 550 (2008).

3. UNITED NATIONS DEVELOPMENT PROGRAMME, HUMAN DEVELOPMENT REPORT: BEYOND SCARCITY: POWER, POVERTY AND THE GLOBAL WATER CRISIS 5 (2006); *The Human Right to Water and Sanitation*, UNITED NATIONS (May 29, 2014), [http://www.un.org/waterforlifedecade/human\\_right\\_to\\_water.shtml](http://www.un.org/waterforlifedecade/human_right_to_water.shtml). Estimates differ on who lacks water, in part due to different parameters for considering what is "adequate." According to a recent UN report, 663 million people lack improved, safe drinking water. Sam Jones, *What Is the Millennium Development Goal on Sustainability All About?*, GUARDIAN (July 23, 2015), <http://www.theguardian.com/global-development/2015/jul/23/millennium-development-goal-seven-sustainability-mdg7-sanitation-deforestation-drinking-water-explainer>.

4. CATARINA DE ALBUQUERQUE, ON THE RIGHT TRACK: GOOD PRACTICES IN REALISING THE RIGHT TO WATER AND SANITATION 20 (2012) [hereinafter DE ALBUQUERQUE, RIGHT TRACK]; HUMAN DEVELOPMENT REPORT, *supra* note 4, at 6; UNITED NATIONS ENVIRONMENT PROGRAMME (UNEP) & UN-HABITAT, SICK WATER? THE CENTRAL ROLE OF WASTEWATER MANAGEMENT IN SUSTAINABLE DEVELOPMENT 40 (Emily Corcoran, et al. eds., 2010),

scarcity also means food scarcity,<sup>5</sup> which further impoverishes and kills millions.

The law can and should ameliorate these catastrophic conditions. One legal gambit: in 2010, the United Nations General Assembly voted<sup>6</sup> that the right to clean drinking water and sanitation is a human right that is “essential for the full enjoyment of life and all human rights.”<sup>7</sup>

South Africa, however, preceded the United Nations (and much of the rest of the world) by fourteen years. In 1996, liberated from the iniquities (but not the inequities) of apartheid, the nation’s constitution proclaimed: “Everyone has the right to have access to sufficient food and water.”<sup>8</sup> Not just empty words on paper, South Africans backed the promise of a right to water through statutes that specified the right, the policies to implement the right, activism to realize and expand the right, and court decisions to delineate the contours of the right.

These legal developments placed South Africa far ahead of other nations in the effort to transform the human right to water from an idealistic aspiration into binding, meaningful law. What happened with the right to water in South Africa matters a great deal. It mattered to the twenty-two million South Africans (fifty-nine percent of the population) who didn’t have a basic water supply at the end of apartheid and who now do (94.8 percent, self-reported in 2013),<sup>9</sup> and is still important to the twelve to fourteen million people who lack basic water access today.<sup>10</sup> It matters to future generations of South Africans who will depend on a non-depleted, legally mandated “Reserve” of water to supply their basic needs,

---

[http://www.unep.org/pdf/SickWater\\_screen.pdf](http://www.unep.org/pdf/SickWater_screen.pdf); Rhett B. Larson, *The New Right in Water*, 70 WASH. & LEE L. REV. 2181, 2182 (2013).

5. HUMAN DEVELOPMENT REPORT, *supra* note 4, at 80.

6. See Press Release, General Assembly, General Assembly Adopts Resolution Recognizing Access to Clean Water, Sanitation as Human Right, by Recorded Vote of 122 in Favour, None against, 41 Abstentions, U.N. Press Release GA/10967 (July 28, 2010) [hereinafter General Assembly Press Release].

7. G.A. Res. 64/292, The Human Right to Water and Sanitation, at 2 (Aug. 3, 2010), <http://www.un.org/es/comun/docs/?symbol=A/RES/64/292&lang=E>.

8. S. AFR. CONST., 1996, § 27(1)(b).

9. DEP’T OF WATER AFFAIRS, STRATEGIC PLAN FOR THE FISCAL YEARS 2013/14 TO 2017/18 (2013) (S. Afr.), <https://www.dwa.gov.za/documents/Other/Strategic%20Plan/2013/Strategic%20plan%20draft%20-%2011%20Mar%202013.pdf>. These numbers come from the Minister of Water & Environmental Affairs. The Constitutional Court in *Mazibuko v. Johannesburg* will quote different figures. *Mazibuko v. City of Johannesburg* 2010 (4) SA 1 (CC) at para. 2 (S. Afr.), <http://www.saflii.org/za/cases/ZACC/2009/28.pdf>.

10. DEP’T OF WATER AFFAIRS & FORESTRY, WHITE PAPER ON THE NATIONAL WATER POLICY FOR SOUTH AFRICA § 2.2.3 (1997), <http://www.dwaf.gov.za/Documents/Policies/nwpwp.pdf>. For a comprehensive overview of these issues, see, for example, DEP’T OF WATER AFFAIRS, BLUE DROP REPORT 2010: SOUTH AFRICAN DRINKING WATER QUALITY MANAGEMENT PERFORMANCE (2010) [hereinafter Dep’t of Water Affairs, Blue Drop]; DEP’T OF WATER AFFAIRS, GREEN DROP REPORT 2009: SOUTH AFRICAN WASTE WATER QUALITY MANAGEMENT PERFORMANCE (2009) [hereinafter Dep’t of Water Affairs, Green Drop].

and it matters to the flora and fauna of functioning ecosystems that similarly depend on clean fresh water.

As the mortality figures quoted above connote, what happens with the right to water in South Africa also matters a great deal outside the nation's borders. It is one thing to declare that all people should have a basic supply of clean water; it is another to make that happen in a country with few rivers, no snowpack, seasonal rain, frequent droughts, and great needs, where most poor citizens live far from sources of water and where international lenders pressure the nation to divest from providing public services.<sup>11</sup> South Africa is one of the world's driest nations,<sup>12</sup> a fledgling democracy recovering from the ravages of apartheid.<sup>13</sup> It is home to millions of impoverished citizens and dramatic income inequality, particularly between Blacks and Whites.<sup>14</sup> Because South Africa had a head start on not only proclaiming that clean water is a basic right but actually delivering on that right, and because it is a democracy with an active, respected judiciary, what happens in South Africa creates international legal and policy precedent regarding the human right to water.<sup>15</sup>

This paper traces the evolution of the right to water in South Africa and explains why it matters both in South Africa and elsewhere. This paper first discusses how South Africa began to realize the right to water despite significant obstacles, ahead of the rest of the world in chronology, in vision, and in law. After the Constitution declared a right to water, South Africa quickly acted to implement that right; this Paper traces the statutes, policies, and court decisions that were forward thinking in attempting to realize this right for South Africa's citizens.

This Paper explains how policymakers resurrected the nation's moribund Public Trust Doctrine, which, when combined with an aggressive commitment to environmental human rights, leads to progressive, holistic law and policy on the contours and implementation of the right to water. This vision marries a commitment to equity in order to counteract the nation's recent heinous

---

11. See *infra* Background on the Right to Water at page 15–16, for discussion and references.

12. SIP 19: ECOLOGICAL INFRASTRUCTURE FOR WATER SECURITY 15 (2014) (S. Afr.) [hereinafter SIP 19]; Louis J. Kotzé & Rebecca Bates, *Similar But Different: Comparative Perspectives on Access to Water in Australia and South Africa*, 15 U. DENV. WATER L. REV. 221, 224 (2012).

13. For the relationship between apartheid, the new Constitution, and water, see, for example, Rose Francis, *Water Justice in South Africa: Natural Resources Policy at the Intersection of Human Rights, Economics, and Political Power*, 18 GEO. INT'L ENVTL. L. REV. 149, 153–58 (2005); Magaziner, *supra* note 3, at 512–16.

14. Income inequality has actually exacerbated since apartheid, and is among the worst in the world. ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), OECD ECONOMIC SURVEYS: SOUTH AFRICA 18 (2013); Murray Liebbrandt et al., *Describing and Decomposing Post-Apartheid Income Inequality in South Africa*, 29 DEV. S. AFR. 19 (2012).

15. George S. McGraw, *Defining and Defending the Right to Water and its Minimum Core: Legal Construction and the Rule of National Jurisprudence*, 8 LOY. U. CHI. INT'L L. REV. 127, 191 (2011); see Paul O'Connell, *The Death of Socio-Economic Rights*, 74 MOD. L. REV. 532, 538 (2011) (noting increasing convergence of approaches to issues of socio-economic rights across countries).



apartheid regime with a profound understanding of ecology. It recognizes that water doesn't just come from the tap: it comes from natural sources that must be stewarded by the sovereign for the benefit of all.

While the Constitution's declaration of the right to water comes with the proviso that the government must "take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of"<sup>16</sup> the right, this Paper explores what those "available resources" actually are or what they could be. This Paper analyzes the government's laws and policy documents; from promising beginnings in the 1997 White Paper on a National Water Policy<sup>17</sup> and 1998 National Water Act,<sup>18</sup> to the visionary, legally binding 2013 National Water Resources Strategy<sup>19</sup> and the 2014 Strategic Implementation Plan 19, "Ecological Infrastructure for Water Security."<sup>20</sup> These documents show that maximizing "available resources" requires the government to fulfill its mandated public trust duties to steward the statutorily required Reserve, which protects the ecological infrastructure that is the source of all water.

Nonetheless, the legal road to marry equity to ecology in South Africa has been bumpy. South Africa shares with all nations competing demands for limited economic and ecological resources. It also embodies the tension between the ideology of neoliberal economic reforms, the demands of human rights, and the ecological reality of a limited source of clean fresh water. Questionable government policies and court decisions took a crimped view of "progressive realization" of the right to water as an economic, social, and cultural right. Actors implementing the right to water further failed to understand what the Public Trust Doctrine demands of governments striving to fulfill the human right to water without squandering the resource for current and future generations.

This Paper analyzes the incorrect holding in the internationally influential (and in some—but not all<sup>21</sup>—quarters, maligned<sup>22</sup>) *Mazibuko v. City of*

16. S. AFR. CONST., 1996 § 27(2).

17. DEP'T OF WATER AFFAIRS & FORESTRY, *supra* note 11.

18. National Water Act 36 of 1998 (S. Afr.), [https://www.dwa.gov.za/Documents/Legislature/nw\\_act/NWA.pdf](https://www.dwa.gov.za/Documents/Legislature/nw_act/NWA.pdf).

19. DEP'T OF WATER AFFAIRS, NATIONAL WATER RESOURCE STRATEGY: WATER FOR AN EQUITABLE AND SUSTAINABLE FUTURE (2d ed. 2013) (S. Afr.), [dwaf.gov.za/nwrs/LinkClick.aspx?fileticket=u\\_qFQycC1bI%3d&tabid=91&mid=496](http://dwaf.gov.za/nwrs/LinkClick.aspx?fileticket=u_qFQycC1bI%3d&tabid=91&mid=496) [hereinafter Dep't of Water Affairs, Resource Strategy].

20. SIP 19, *supra* note 13.

21. See, e.g., Catarina de Albuquerque (Special Rapporteur on the Human Right to Safe Drinking Water and Sanitation), *Addendum: Compilation of Good Practices*, ¶ 96, U.N. Doc. A/HRC/18/33/Add.1 (June 29, 2011) [hereinafter de Albuquerque, *Good Practices*]; Tracy Humby & Maryse Grandbois, *The Human Right to Water in South Africa and the Mazibuko Decisions*, 51 LES CAHIERS DE DROIT 521, 538–40 (2010) (Can.) (finding the Court's decision was prudent and appropriate given development challenges and the still fragile constitutional system of human rights in South Africa); Eusebius McKaiser, *Court Strikes Right Balance on Water for Poor People*, BUSINESS DAY, Oct. 13, 2009, <http://www.bdlive.co.za/articles/2009/10/13/court-strikes-right->

*Johannesburg* (2010)<sup>23</sup> case, where indigent petitioners challenged the government's policy to: a) designate a low amount of free basic water to fulfill the right to water and b) install prepaid water meters that shut off without notice, leaving individuals without water. The Constitutional Court, however, deferred to the government's expertise in determining the contours of economic, social, and cultural rights.

This Paper argues that the Constitutional Court—like so many other lawyers and bureaucrats, including respected international sources such as the United Nations Special Rapporteur on the Human Right to Safe, Clean Water—failed to see water provision not just as a problem of economy, but as a problem of ecology. Water becomes a limited economic resource when it is a mismanaged ecological resource. Thus in *Mazibuko*, as elsewhere, the Constitutional Court simply ignored what a government is required to do as a public trustee of an imperiled public resource: it ignored the part of the National Water Act that focused on sustaining the ecological Reserve for present and future generations—and thus failed to successfully manage its “available resources” as the Constitution demands.<sup>24</sup>

These errors matter not just for the indigent population's ability to live lives of dignity; they matter for other nations looking to South African policies and subsequent jurisprudence as they craft their own responses to emerging international legal demands that governments respect, protect, and fulfill<sup>25</sup> the human right to water.

Despite the South African government's reluctance to fulfill the right to water more aggressively and the Constitutional Court's reluctance to require that they do so, lawmakers and bureaucrats have presented a vision of deeply equitable implementation of the human right to water. Deep equity means implementing and inspiring laws, policies, and values that simultaneously and

---

balance-on-water-for-poor-people (supporting the South African Constitutional Court's decision in *Mazibuko*, striking the right balance on maintaining the Court's institutional role with respect to socioeconomic policies).

22. See e.g., McGraw, *supra* note 16, at 198–99; O'Connell, *supra* note 16, at 532; Murray Wesson, *Reasonableness in Retreat? The Judgment of the South African Constitutional Court in Mazibuko v City of Johannesburg*, 11(2) HUM. RTS. L. REV. 390 (2011) (critiquing the Court's decision for its limited understanding of its role in enforcing social and economic rights and endorsement of a policy which would often deny poor people access to adequate water); Pierre De Vos, *Water Is Life (But Life Is Cheap)*, CONSTITUTIONALLY SPEAKING (Oct. 13, 2009), <http://constitutionallyspeaking.co.za/water-is-life-but-life-is-cheap>.

23. *Mazibuko v. City of Johannesburg* 2010 (4) SA 1 (CC) (S. Afr.). See generally O'Connell, *supra* note 16, at 550–52; Wesson, *supra* note 23 (providing a comprehensive overview of the legal arguments in *Mazibuko*).

24. S. AFR. CONST., 1996, § 27(2).

25. International Commission of Jurists (ICJ), *Maastricht Guidelines on Violations of Economic, Social and Cultural Rights*, Jan. 26, 1997, [https://www1.umn.edu/humanrts/instree/Maastrichtguidelines\\_.html](https://www1.umn.edu/humanrts/instree/Maastrichtguidelines_.html) [hereinafter *Maastricht Guidelines*]; DE ALBUQUERQUE, RIGHT TRACK, *supra* note 5, at 22.

synergistically advance the health and potential of individuals, human communities, and nonhuman communities.<sup>26</sup>

In four documents spanning seventeen years, South Africa has presented a remarkable vision for how governments can and must fulfill public trust responsibilities to protect the human right to water through the protection of the ecological source that nourishes that right. This Paper examine how, after getting the right to water right and then wrong, South Africa may be back on track to getting it right again. The four legal documents this Paper analyzes present a holistic, exemplary view of the role of water in community life. They ground the Public Trust Doctrine—legally and scientifically—in the actual ecological matrix that supports all life. They combine this with a fundamental commitment to correcting past discriminatory wrongs: water is the centerpiece that links equity to ecology. These documents provide a holistic, farsighted, and deeply equitable vision of water as a resource for sustainable economic development, grounded in a vision of the “indivisibility of water”<sup>27</sup> as the ecological resource that forms the basis of all human and nonhuman life.

The world’s nations face difficult choices for how to structure laws that enable all citizens to realize their right to safe, clean water. This situation will only worsen as human populations grow and climate change makes it more difficult to secure sources of water. In South Africa, the legal elements are aligned to manage the most imperiled and precious ecological resource equitably while providing for the needs of its citizens without depleting the Reserve for present and future generations of humans and nonhumans. If implemented close to the plans detailed in these documents, South Africa would reclaim its position as the international leader in demonstrating how to fulfill the right to water by satisfying public trust responsibilities as guardians and providers of a nation’s water resources, without wasting the economic or ecological reserves. South Africa has the chance to lead the world in development that is truly sustainable, fulfills human rights, and is deeply equitable for present and future generations of humans and nonhumans.

## I. BACKGROUND

### A. *The Right to Safe Clean Water*

Fresh, drinkable water is sparse and unevenly distributed on our planet, with poverty closely linked to water scarcity and water pollution.<sup>28</sup> The figures in the Introduction—over one billion people lacking access to safe clean water, with the catastrophic health impacts that portends—mean that currently, neither

---

26. David Takacs, *Forest Carbon Offsets and International Law: A Deep Equity Legal Analysis*, 22 GEO. INT’L ENVTL. L. REV. 521, 526 (2010).

27. DEP’T OF WATER AFFAIRS, RESOURCE STRATEGY, *supra* note 20, at 37.

28. Magaziner, *supra* note 3, at 550.

human rights law nor environmental law are successfully remedying this dire problem.

Scholars have reviewed how lawyers and other activists built the case for the human right to water.<sup>29</sup> Given water's centrality to realizing all other rights, it is odd that activists had to lobby for water's status as a fundamental human right. Perhaps the framers of the modern human rights treaties simply assumed water's perpetual availability: humans often take the gifts of nature for granted and pay attention only when these resources are no longer available.<sup>30</sup> Eventually, in 2010, the United Nations ("UN") General Assembly voted 122–0 (with forty-one abstentions) that the right to clean drinking water and sanitation is a human right that is "essential for the full enjoyment of life and all human rights."<sup>31</sup>

The UN Committee on Economic, Social, and Cultural Rights and various nongovernmental organizations ("NGOs"), have endeavored to put content behind the right, as has the UN-appointed Special Rapporteur on the Human Right to Safe Drinking Water and Sanitation, whose reports outline the contours of availability, quality, acceptability, affordability, and quantity.<sup>32</sup> In a nutshell, according to the UN Committee, "The human right to water entitles everyone to sufficient, safe, acceptable, physically accessible and affordable water for personal and domestic uses. An adequate amount of safe water is necessary to prevent death from dehydration, to reduce the risk of water-related disease and

---

29. See, e.g., de Albuquerque, *Good Practices*, supra note 22, at 4 (discussing development in international human rights law with respect to water and sanitation as well as initiatives and organizations working on rights to water and sanitation in the context of development cooperation); CATARINA DE ALBUQUERQUE, *REALISING THE HUMAN RIGHTS TO WATER AND SANITATION: A HANDBOOK*, INTRODUCTION 23–24 (2014) [hereinafter DE ALBUQUERQUE, *HANDBOOK*]; DE ALBUQUERQUE, *RIGHT TRACK*, supra note 5, at 25–27, 47–51; OFFICE OF THE U.N. HIGH COMM'R ON HUMAN RIGHTS, *THE RIGHT TO WATER: FACT SHEET NO. 35* 3–7 (2010), <http://www.ohchr.org/Documents/Publications/FactSheet35en.pdf>; S. AFR. HUMAN RIGHTS COMM'N, *REPORT ON THE RIGHT TO ACCESS SUFFICIENT WATER AND DECENT SANITATION IN SOUTH AFRICA: 2014* 24–34 (2014); Doug Donoho, *Some Critical Thinking About a Human Right to Water*, 19 ILSA J. INT'L & COMP. L. 91 (2012) (finding that recognition of international human right to water will face significant resistance domestically and internationally); Magaziner, supra note 3, at 550–60 (discussing ways in which the international community has declared legal and human right to water); McGraw, supra note 16 (explaining the legal content of the human right to water, including its minimum core, and the way in which national jurisprudence for the protection of water rights interacts with this international legal construct).

30. Gleick postulates "that the framers of the UDHR considered" the right water "as fundamental as air." Peter H. Gleick, *The Human Right to Water*, 1 WATER POL'Y 487, 491 (1998).

31. South Africa voted yes, and the United States abstained. G.A. Res. 64/292, supra note 8, at 2; General Assembly Press Release, supra note 7.

32. See, for example, the well-regarded CENTRE ON HOUSING RIGHTS AND EVICTIONS (COHRE) ET AL., *MANUAL ON THE RIGHT TO WATER AND SANITATION* (2007); Catarina de Albuquerque (Special Rapporteur on the Human Right to Safe Drinking Water and Sanitation), *Common violations of the human rights to water and sanitation*, U.N. Doc. A/HRC/27/55 (June 30, 2014) [hereinafter de Albuquerque, *Common Violations*]; de Albuquerque, *Good Practices*, supra note 22; DE ALBUQUERQUE, *RIGHT TRACK*, supra note 5, at 32–35.

to provide for consumption, cooking, personal and domestic hygienic requirements.”<sup>33</sup>

### B. *The Right to Water Mischaracterized*

International human rights law divides the world between civil and political (“CP”) rights, often viewed as priority rights to be implemented immediately, and economic, social, and cultural (“ESC”) rights, to be realized progressively as resources allow.<sup>34</sup> The right to water has been classified both internationally and in South Africa’s Constitution as an ESC right, which is a misclassification. But even if it is not, its status as an ESC right is misinterpreted to allow underperformance of the right. If reclassified as a CP right, nations would then only be allowed to derogate from the obligation if resources (human, technological, financial, ecological) simply are not available through no fault of the government.

The UN Committee on Economic, Social and Cultural Rights advocates that access to clean water is a human right because it is “indispensable for leading a life in human dignity” and a “prerequisite to the realization of all other human rights.”<sup>35</sup> If an individual is deprived of water, he or she cannot enjoy any of the other essential rights. Water is, simply, life. Consider the peremptory *jus cogens* norms (i.e. norms which all states must obey without exception, including freedom from slavery and torture), an individual can survive these actions but cannot survive without clean, safe, water. As one scholar described it, “[w]ater is a peculiar ‘primary need’ because it is the only primary need a government is capable of providing for which there is no substitute. There are different kinds of food, energy, shelter, education, employment, and health care. But only water is water.”<sup>36</sup> According to U.S. water expert Peter Gleick, to fail to recognize a fundamental right to water, “would mean that there is no right to the single most important resource necessary to satisfy the human rights more explicitly guaranteed by the world’s primary human rights declarations and covenants.”<sup>37</sup>

For now, the right to water remains an ESC right. Human rights lawyers debate the most theoretically and practically apt approach to the right to water and other ESC rights. For example, how to define an empirically based minimum core that provides a lodestar to lawmakers, advocates, and judges?

---

33. General Comment No. 15, The Right to Water (Arts. 11 and 12 of the International Covenant on Economic, Social and Cultural Rights), CESCR on Its Twenty-Ninth Session, U.N. Doc. E/C.12/2002/11 (Jan. 20, 2003), *reprinted in* Compilation of General Comments and General Recommendations Adopted by Human Rights Treaty Bodies, ¶ 2, U.N. Doc. HRI/GEN/1/Rev.6 (May 12, 2003) [hereinafter General Comment 15].

34. LORI F. DAMROSCH ET AL., INTERNATIONAL LAW: CASES AND MATERIALS 978 (5th ed. 2009); JAVAID REHMAN, INTERNATIONAL HUMAN RIGHTS LAW: A PRACTICAL APPROACH 6–7 (2003).

35. General Comment 15, *supra* note 34, at ¶ 1.

36. Larson, *supra* note 5, at 2193.

37. Gleick, *supra* note 31, at 493.

What about using a sliding scale of “reasonableness” to adjudicate whether a particular entity has made sufficient progress in realizing the particular right? This Paper argues that an approach worth defending is to make it the default obligation for governments to ensure every citizen has secured a minimum core supply of safe, clean water. The UN Committee on Economic, Social and Cultural Rights believes that “a minimum core obligation to ensure the satisfaction of, at the very least, minimum essential levels of each of the rights is incumbent upon every State party” within available resources.<sup>38</sup> The Committee notes that “sufficient” water is what is necessary to “prevent death from dehydration, to reduce the risk of water related disease and to provide for consumption.”<sup>39</sup>

Under whichever aegis the right to water is classified, experts can derive this minimum core from empirical data of how much a human needs to survive and thrive.<sup>40</sup> The UN Development Programme urges a survival minimum of twenty liters per person per day (the average person in the United States uses more than twenty times that amount),<sup>41</sup> while the World Health Organization and the UN General Assembly’s resolution specify that the right is fulfilled when everyone has access to fifty to one hundred liters per day within one kilometer of a residence and which costs less than three percent of a household income.<sup>42</sup> Peter Gleick’s affidavit in the *Mazibuko* case provides empirical evidence for a fifty liters per person per day minimum for “cleaning, hygiene, drinking, cooking, and basic sanitation,”<sup>43</sup> i.e., to be able to lead a dignified life. Absolute amounts can be higher for special cases (e.g., pregnant women, people with HIV/AIDS, people who do hard labor and/or live in hot climates).

### C. *Progressive Realization, Progressive Loopholes*

The South African Constitution provides a large margin of discretion on the right to water: the “state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of each of these rights.”<sup>44</sup> This language parallels the loophole in the 1966 International

---

38. General Comment No. 3, The Nature of States Parties’ Obligations (art. 2 para. 1 of the Covenant), CESCR on Its Fifth Session, 86 U.N. Doc. E/1991/23, Annex III (1991), *reprinted in* Compilation of General Comments and General Recommendations Adopted by Human Rights Treaty Bodies, ¶ 10, U.N. Doc. HRI/GEN/1/Rev.6 (May 12, 2003) [hereinafter General Comment 3].

39. General Comment 15, *supra* note 34, at ¶ 2. Although South Africa did not ratify the International Covenant on Economic Social and Cultural Rights until January 2015, in *Mazibuko*, High Court Judge Tsoka nonetheless cited the Covenant’s expert committee for expert guidance.

40. McGraw, *supra* note 16, at 199.

41. HUMAN DEVELOPMENT REPORT, *supra* note 4, at 5.

42. G.A. Res 64/292, *supra* note 8; HUMAN DEVELOPMENT REPORT, *supra* note 4, at 34.

43. Patrick Bond & Jackie Dugard, *The Case of Johannesburg Water: What Really Happened at the Pre-Paid ‘Parish Pump,’* 12 L. DEMOCRACY & DEV. 1, 13 (2008); Magaziner, *supra* note 3, at 578.

44. S. AFR. CONST., 1996, § 27(2); McGraw, *supra* note 16, at 153.

Covenant on Economic, Social, and Cultural Rights (ICESCR):<sup>45</sup> “Each State Party to the present Covenant undertakes to take steps, individually and through international assistance and co-operation, especially economic and technical, to the maximum of its available resources, with a view to achieving progressively the full realization of the rights recognized in the present Covenant by all appropriate means, including particularly the adoption of legislative measures.”<sup>46</sup>

Thus, “Progressive realization” of ESC rights gives wide latitude to governments on how, when, where, and why they provide certain services, and gives courts similar latitude in judging whether or not governments are making adequate progress toward fulfilling a given right.<sup>47</sup> But it doesn’t give unlimited latitude, as the Committee on Economic, Social, and Cultural Rights points out: “the burden is on the State to demonstrate that it is making measurable progress toward the full realization of the rights in question. The State cannot use the ‘progressive realization’ provisions in article 2 of the Covenant as a pretext for non-compliance.”<sup>48</sup>

In the 1987 Limburg Principles, the International Commission of Jurists<sup>49</sup> noted that progressive realization of an ESC right means “equitable and effective use of and access to the available resources” for citizens owed rights.<sup>50</sup> Revisiting those standards ten years later, the Commission further elaborated. Recognizing the reality of market-based reforms (in the context of water this means privatizing water provision or water itself), it nonetheless reiterated that States are ultimately responsible for provision of ESC rights.<sup>51</sup> The jurists noted that like civil and political rights, ESC rights impose obligations to respect (refrain from interfering or directly restricting), protect (prevent violations by third parties), and fulfill (“to take appropriate legislative, administrative, budgetary, judicial and other measures towards the full realization of”) a given right.<sup>52</sup> While States have a “margin of discretion” in how they implement ESC

---

45. While President Nelson Mandela signed the ICESCR in 1994, it wasn’t until January 2015 that the South African legislature ratified the Convention.

46. International Covenant on Economic, Social and Cultural Rights art. 2(1), Dec. 16, 1966, 993 U.N.T.S. 3.

47. McGraw, *supra* note 16, at 153.

48. *Maastricht Guidelines*, *supra* note 26, at ¶ 8.

49. See generally INTERNATIONAL COMMISSION OF JURISTS, <http://www.icj.org> (last visited Mar. 17, 2016).

50. Permanent Mission of the Netherlands to the United Nations Office at Geneva, Address to the Centre for Human Rights, The Limburg Principles on the Implementation of the International Covenant on Economic, Social and Cultural Rights, U.N. Doc E/CN.4/1987/17, Annex (Aug. 1, 1987), reprinted in 9 HUM. RTS. Q. 122 (1987), [http://www.soas.ac.uk/cedep-demos/000\\_P514\\_IEL\\_K3736-Demo/treaties/media/1987%20UN%20Limburg%20principles.pdf](http://www.soas.ac.uk/cedep-demos/000_P514_IEL_K3736-Demo/treaties/media/1987%20UN%20Limburg%20principles.pdf) [hereinafter Limburg Principles].

51. *Maastricht Guidelines*, *supra* note 26.

52. *Id.* ¶ 6. Similarly, “Violations of economic, social and cultural rights can occur through the direct action of States or other entities insufficiently regulated by States. Examples of such violations include: I The active support for measures adopted by third parties which are inconsistent

rights, decisions by international experts and various domestic courts provide requirement guidelines.<sup>53</sup> The Commission is explicit that a minimum core of some rights exists.<sup>54</sup> Finally, the Commission outlines acts of omission, i.e. failure to take certain steps including: (a) the failure to utilize the maximum of available resources towards the full realization of the Covenant, (b) the failure to remove promptly obstacles which it is under a duty to remove, and (c) the failure to meet a generally accepted international minimum standard of achievement, which is within its powers to meet.<sup>55</sup>

According to South African scholar Reynaud Daniels, available resources “include human resources, technological resources, information resources as well as material and financial resources.”<sup>56</sup> As the Limburg Principles state, “[t]he obligation of progressive achievement exists independently of the increase in resources; it requires effective use of resources available.”<sup>57</sup> And, as this Paper will discuss, South African government water providers have not made efficient use of available technological or financial resources.

Missing both here and in analysis (including the courts’ own analyses) of the right to water is the discussion of *ecological* resources. This Paper will return to this in great detail below in the South African context.

#### *D. Economic, Social, and Cultural Rights Jurisprudence in South Africa*

The South African Constitution buttressed the right to water and other ESC rights with additional rights to equality,<sup>58</sup> dignity,<sup>59</sup> a healthy environment,<sup>60</sup> participation in decision-making,<sup>61</sup> and to access effective government.<sup>62</sup> South Africa has received international attention for its Constitutional Court’s adjudication of ESC rights.<sup>63</sup> In *The Government of the Republic of South Africa v. Irene Grootboom*,<sup>64</sup> indigent citizens successfully sued the government for violating numerous ESC rights. The Constitutional Court held that the

---

with economic, social and cultural rights.” *Id.* ¶ 14.

53. *Id.* ¶ 8.

54. *Id.* ¶ 9.

55. Maastricht Guidelines, *supra* note 26, ¶¶ 15(e), 15(g), 15(i).

56. Reynaud Daniels, *Implementation of the Right of Access to Sufficient Water Through Privatization in South Africa*, 15 PENN. ST. ENVTL. L. REV. 61, 82 (2006) (footnotes omitted); Robert E. Robertson, *Measuring State Compliance with the Obligation to Devote the “Maximum Available Resources” to Realizing Economic, Social and Cultural Rights*, 16 HUM. RTS. Q. 693, 693–702 (1994).

57. Limburg Principles, *supra* note 51, ¶ 23.

58. S. AFR. CONST., 1996, § 9.

59. *Id.* § 10.

60. *Id.* § 24.

61. *Id.* §§ 32–34.

62. *Id.* § 195.

63. Malcolm Langford, *Domestic Adjudication and Economic, Social and Cultural Rights: A Socio-Legal Review*, 6 INT’L J. ON HUM. RTS. 11, 91 (2009).

64. *Gov’t of the Republic of S. Afr. v. Grootboom* 2000 (11) BCLR 1169 (CC) (S. Afr.)



government is obliged “to provide access to housing, health-care, sufficient food and water, and social security to those unable to support themselves and their dependants. The state must also foster conditions to enable citizens to gain access to land on an equitable basis.”<sup>65</sup> The Court acknowledged that it is an “extremely difficult task for the state to meet these obligations in the conditions that prevail in [the] country,” but held that “despite all these qualifications, these are rights, and the Constitution obliges the state to give effect to them.”<sup>66</sup> Noting the “harsh reality that the Constitution’s promise of dignity and equality for all remains for many a distant dream,”<sup>67</sup> the Court ruled that it is “beyond question” that all the rights of the constitution are justiciable but the question remains of “how to enforce them in a given case.”<sup>68</sup> The government’s obligations to fulfill these rights are manifold. Legislation alone is not enough and must be “supported by appropriate, well-directed policies and programmes,” which themselves “must also be reasonably implemented.”<sup>69</sup> While the Court acknowledged that available resources may constrain what the government is capable of doing, in this case the “nationwide housing programme f[ell] short of obligations imposed upon national government to the extent that it fail[ed] to recognise that the state must provide for relief for those in desperate need.”<sup>70</sup>

Two years later, in the internationally influential *Treatment Action Campaign v. Minister of Health*, the Court held that the government was not “reasonable” when it withheld access to a drug that prevented HIV transmission from mother to child when the government had the resources to provide the drug more widely.<sup>71</sup> And in *Khosa v. Minister of Social Development*, the Court held that it was unreasonable to withhold ESC benefits (in that case, social security) from a permanent resident who was not a full citizen.

What the Court did not do in these cases was adopt a “minimum core” standard that specified some foundational level of a given right that the government must guarantee. Instead, the Court adopted a “reasonableness” standard for judging government’s adequacy in fulfilling ESC rights, and left it to the government to make sufficient progress towards fulfilling these rights, applying a higher level of scrutiny when rights of the most indigent are allegedly impaired.<sup>72</sup>

---

65. *Id.* at para. 93.

66. *Id.* at para. 94.

67. *Id.* at para. 2.

68. *Id.* at para. 20.

69. *Id.* at para. 42.

70. *Id.* at para. 66.

71. *Treatment Action Campaign v. Minister of Health*, 2002 (5) SA 721 (CC) at paras. 67–73 (S. Afr.).

72. *Grootboom* 2000 (11) BCLR 1169 (CC) at paras. 66–69; Francis, *supra* note 14, at 189–90; Kotzé & Bates, *supra* note 13, at 248.

*E. Background on the Right to Water in South Africa*

In the case of *Mazibuko v. City of Johannesburg*, which is discussed at length below, the Constitutional Court introduced the problem of water in South Africa:

Although rain falls everywhere, access to water has long been grossly unequal. This inequality is evident in South Africa. While piped water is plentifully available to mines, industries, some large farms and wealthy families, millions of people, especially women, spend hours laboriously collecting their daily supply of water from streams, pools and distant taps. In 1994, it was estimated that 12 million people (approximately a quarter of the population), did not have adequate access to water. By the end of 2006, this number had shrunk to 8 million, with 3.3 million of that number having no access to a basic water supply at all.<sup>73</sup>

Currently, between 85 percent (according to the South African Human Rights Commission) and 94.8 percent (according to the Department of Water Affairs) of South African households have access to a basic supply of water; however, in some poorer areas, that figure is much lower.<sup>74</sup> For example, in the relatively wealthy Western Cape province, over 75 percent of residents have water piped into their dwelling, and only 3.3 percent lack a basic supply within two hundred meters of their home. On the other hand, in Limpopo province, only 18.4 percent of residents have water piped into their home, and 27.2 percent lack access to a regular supply of acceptable water within two hundred meters.<sup>75</sup>

South Africa has improved access to safe, clean water despite facing tremendous challenges. South Africa is the thirtieth driest country in the world.<sup>76</sup> It has few rivers, no mountain snow pack, low annual rainfall, and extreme seasonal variability in precipitation. Ninety-two percent of water evaporates before reaching a waterway.<sup>77</sup> The country is currently using ninety-eight percent of its available water supply.<sup>78</sup> Yet water demand is expected to grow by over thirty percent by 2030.<sup>79</sup> The country suffers from droughts, which will only be exacerbated by climate change. South Africa's temperature increase

73. *Mazibuko v. City of Johannesburg* 2010 (4) SA 1 (CC) at para. 2 (S. Afr.); but see DEP'T OF WATER AFFAIRS, STRATEGIC PLAN, *supra* note 10 (offering different figures).

74. S. AFR. HUMAN RIGHTS COMM'N, *supra* note 30, at 14; DEP'T OF WATER AFFAIRS, STRATEGIC PLAN, *supra* note 10; Kotzé & Bates, *supra* note 12, at 230.

75. S. AFR. HUMAN RIGHTS COMM'N, *supra* note 30, at 38–39.

76. SIP 19, *supra* note 13, at 15.

77. D.C. Le Maitre et al., *Invasive alien trees and water resources in South Africa: case studies of the costs and benefits of management*, FOREST ECOLOGY AND MANAGEMENT 160, 143–59 (2002); DEP'T OF WATER AFFAIRS, NATIONAL WATER RESOURCE STRATEGY, *supra* note 20, at 8–9.

78. JESSICA WILSON & TARYN PEREIRA, WATER DEMAND MANAGEMENT'S SHADOW SIDE: TACKLING INEQUALITY AND SCARCITY OF WATER PROVISION IN CAPE TOWN 18 (2012); Lorenzo Fioramonti, *Water Shortages About to Put Load-Shedding in the Dark*, BUSINESS DAY, May 5, 2015, <http://www.bdlive.co.za/opinion/2015/05/05/water-shortages-about-to-put-load-shedding-in-the-dark>.

79. WWF-SA, FARMING FACTS AND FUTURES: RECONNECTING SOUTH AFRICA'S FOOD SYSTEMS TO ITS ECOSYSTEMS 20 (Inge Kotzé & Marlene Rose eds., 2015).

during the past five decades has been twice the global average.<sup>80</sup> Alien invasive plants choke waterways. A high percentage of South Africa's water originates in neighboring countries, beyond domestic control in terms of quantity and quality.<sup>81</sup> Populations are mismatched to water sources; due to its history, a large proportion of the population live near the mines or other industries where they worked and/or were segregated in distant former "homelands" apart from White population centers.<sup>82</sup> As a further legacy of apartheid, water rights have been linked to land ownership, which was formerly limited to Whites. Irrigated agriculture uses about sixty percent of the available water, and industry another sixteen percent, leaving only a small portion of scarce water available for basic human needs.<sup>83</sup>

Since liberation, South Africa has struck an uneasy balance between water as a human right entitlement and as an economic commodity.<sup>84</sup> At the end of apartheid, the nation was desperate for international financing to improve conditions for the majority of its citizens who had been cruelly underserved. At the same time, South Africa was leading the world in requiring progressive fulfillment of citizens' rights to safe, clean water, a parallel philosophy emerged internationally: when water is given away, it is wasted, and thus governments should stop providing water (and other services) for free.<sup>85</sup> International lenders encourage governments to outsource water (and other services) provision to private companies; if governments continue to directly provide services, they should regard citizens as paying consumers and aim for full cost recovery for providing the service.<sup>86</sup>

In exchange for World Bank loans, the South African government bought into the paradigm of "fiscal responsibility" in water delivery.<sup>87</sup> While the Public Trust Doctrine (see below) demands that water stay in public hands, the South African government nonetheless requires that water service providers run on a private sector model: water isn't something that can just be given away.<sup>88</sup> Below this Paper will explore the tensions inherent to charging people for water as an

---

80. *Id.* at 22; SIP 19, *supra* note 13, at 20–23.

81. Kotzé & Bates, *supra* note 13, at 231.

82. Francis, *supra* note 14, at 153–54.

83. DEP'T OF WATER AFFAIRS, NATIONAL WATER RESOURCE STRATEGY, *supra* note 20, at 55; WWF-SA, *supra* note 81, at 22.

84. *See* S. AFR. HUMAN RIGHTS COMM'N, *supra* note 30, at 26–27.

85. For more on how this philosophy evolved, see David Takacs, *Water Sector Reform and Principles of International Environmental Law*, in *WATER LAW FOR THE TWENTY-FIRST CENTURY: NATIONAL AND INTERNATIONAL ASPECT OF WATER LAW REFORM IN INDIA* 260, 262–72 (Philippe Cullet et al. eds., 2009).

86. *See generally, id.* at 260–86.

87. In 2011, the debt interest on these loans was \$4 billion USD. *See e.g.*, Bond & Dugard, *supra* note 44, at 17; Francis, *supra* note 14, at 157; Peter Danchin, *A Human Right to Water? The South African Constitutional Court's Decision in the Mazibuko Case*, EJIL: TALK! (Jan. 13, 2010), <http://www.ejiltalk.org/a-human-right-to-water-the-south-african-constitutional-court%E2%80%99s-decision-in-the-mazibuko-case/>.

88. For an analysis of this development, see, for example,

economic good and providing water as a human right and a social good.<sup>89</sup> South Africa, though one of the continent's richest nations, still suffers from staggering inequality and large numbers of impoverished people, which the South African Human Rights Commission calls "an enduring apartheid spatial geography."<sup>90</sup> The politics of full cost recovery for water, as seen below, reifies these cartographic economic and racial distinctions. In the words of South African economist Guy Mhone, "[i]n the hearts and minds of every black South African, nothing will ever compare to apartheid . . . But there is a very real frustration now that we have only exchanged the savagery of apartheid for the savagery of an untethered free market."<sup>91</sup>

South Africa also faces daunting social problems that exacerbate the difficulties surrounding the right to water. At the time of this writing, a wave of violent xenophobia has been unleashed, aimed at migrants who compete with citizens for jobs.<sup>92</sup> Over five million South Africans are estimated to be HIV positive, with the government straining to provide drugs and services to them.<sup>93</sup> The education system is poor, unemployment is rampant, and income inequality between rich and poor (and thus White and Black) is growing, not shrinking.<sup>94</sup> Poor governance and corruption plagues sectors of South Africa's government.<sup>95</sup> This was a common theme—voiced by government functionaries, NGO activists, and citizens—everywhere in South Africa. Local government agencies are poorly equipped to provide water services.<sup>96</sup> They face inadequate budgets, insufficient technical expertise, a dire shortage of water engineers, and inadequate supervision of external contractors meant to deliver water or install water technology (e.g., infrastructure in social housing)—to deliver the services that the central government has devolved to them.<sup>97</sup> At the time of this writing, South Africa is experiencing "load shedding," where the nation's inadequate electricity generating capacity means many areas of the country go dark for at

---

89. For further discussion on a neoliberal view of water as an economic commodity with special attention to South Africa, see, for example, Bond & Dugard, *supra* note 44, at 4; S. AFR. HUMAN RIGHTS COMM'N, *supra* note 30, at 7; Magaziner, *supra* note 3, at 523–24; O'Connell, *supra* note 16, at 534; Tara E. Paul, *Plugging the Democracy Drain in the Struggle for Universal Access to Safe Drinking Water*, 20 IND. J. GLOBAL LEGAL STUD. 469, 471–72 (2013); Barton H. Thompson, Jr., *Water as a Public Commodity*, 95 MARQ. L. REV. 17 (2011).

90. S. AFR. HUMAN RIGHTS COMM'N, *supra* note 30, at 7.

91. Jon Jeter, *South Africa's Driest Season*, MOTHER JONES, Nov. 1, 2002, at 1, <http://www.motherjones.com/politics/2002/11/south-africas-driest-season>.

92. See David Smith, *Xenophobia in South Africa: 'They Beat My Husband With Sticks and Took Everything'*, GUARDIAN Apr. 17, 2015, <http://www.theguardian.com/world/2015/apr/17/xenophobia-south-africa-brothers-violence-foreigners>.

93. See Humby & Grandbois, *supra* note 22, at 525.

94. See, e.g., Liebbrandt, *supra* note 15, at 19; OECD, *supra* note 15, at 24–25.

95. See, e.g., S. AFR. HUMAN RIGHTS COMM'N, *supra* note 30, at 14; Kotzé & Bates, *supra* note 13, at 231; OECD, *supra* note 15, at 19.

96. OECD, *supra* note 15, at 25.

97. See e.g., S. AFR. HUMAN RIGHTS COMM'N, *supra* note 30, at 14–16; Humby & Grandbois, *supra* note 22, at 528.

least two hours a day.<sup>98</sup> While an individual can live two hours a day without electricity, in conversations with authorities I was warned that a coming era of ‘water shedding’ will make life considerably more difficult. This is just an inkling of the broader milieu in which the struggle for water in South Africa plays out.

#### *F. Deep Equity and the Right to Water*

“Deep equity”<sup>99</sup> means laws, policies, or actions are “right” or “good” if they simultaneously and synergistically maximize individual human health and potential, human community health and potential, and non-human health and potential. Equity is deep when values become rooted within each individual, when we fundamentally reimagine our community and government structures and responsibilities, and when these values and responsibilities become entrenched and encoded in our legal systems. In turn, our laws would then support policies, actions, and values promoting even deeper equity.

The South African Human Rights Commission asserts that the Constitution’s “revolutionary commitment to dignity, equality and social justice has the potential to transform old fault-lines of political, economic and social power.”<sup>100</sup> The framework South Africa has provided for the right to water in the four legal and policy documents discussed below present a deeply equitable vision of the role of water in community life. When resurrecting the Public Trust Doctrine, lawmakers specified that government trustees must manage water supplies to sustain human individuals and communities while preserving the ecological matrix from which all water comes—which simultaneously and synergistically sustains nonhuman lives now and in the future. All water provision is rooted in the twin goals of serving the needs of the most indigent while sustaining a “Reserve,” explicitly intended to sustain adequate supplies of water for present and future generations of humans and nonhumans. This vision of intra- and intergenerational equity inextricably ties essential human needs to the ecological source that fulfills those human needs, putting responsibility in the hands of the public trustees to manage a fragile, life sustaining ecological resource. If the legal frameworks detailed in the four documents below are implemented well, they provide a model for all nations (developed and developing) for how to manage and maximize in a deeply equitable way a scarce resource for a population with growing needs.

#### *G. Thinking about Environmental Problems*

How we conceive of environmental problems shapes how we solve these problems in law. Environmental law covers wide ground as it addresses

---

98. Norimitsu Onishi, *Weak Power Grids in Africa Stunt Economies and Fire Up Tempers*, N.Y. TIMES, July 2, 2015.

99. For elaboration, see Takacs, *supra* note 27.

100. S. AFR. HUMAN RIGHTS COMM’N, *supra* note 30, at 7.

environmental problems, which occur when human action impacts assets from the nonhuman biological or physical world, creating difficulties for humans or nonhumans. Thus water scarcity is an environmental problem because it concerns a resource from the physical world (water) adversely impacted by human action (overuse, inequitable distribution, pollution from erosion, waste water treatment plants, industries, and mining),<sup>101</sup> and neglect of technological and ecological infrastructure with resulting problems for humans (shortage or contamination) and/or nonhumans (shortage or contamination). Thus, environmental laws about water may address a spectrum of concerns: how best to fulfill the human right to a basic share of clean water? How best to protect nonhuman species that also require clean water? Who or what may use shared waterways? What type of infrastructure is constructed and maintained? Who must steward water resources? Who participates in decision making about how water is distributed and managed?

Too often in South Africa (and elsewhere), water managers have derived legal solutions to environmental problems that are not rooted in environmental law. For example, they frame the problem of water scarcity as people not paying (not paying enough or at all) for the water they receive, thus wasting it.<sup>102</sup> The South African National Water Act 36 of 1998 declares: “Water use charges will be used as a means of encouraging reduction in waste, and provision is made for incentives for effective and efficient water use. Non-payment of water use charges will attract penalties, including the possible restriction or suspension of water supply from a waterwork or of an authorization to use water.”<sup>103</sup> Even if the assumption is wholly or partly true (I will interrogate this below), this takes an economic approach to an environmental problem. Without environmental approaches to the environmental problem, “progressive realisation” of the right to water is not nearly as progressive as it could or should be.

Do we waste what we don’t value, and don’t value it unless we pay for it? Water law scholar Rhett Larson suggests that “[a] provision right to water framed in a manner opposed to water pricing and cost recovery is not only counterproductive to its presumed end of protecting disadvantaged communities but it also poses risks to ecologic sustainability and human health. Appropriate water pricing encourages sustainable use.”<sup>104</sup> He adds, “focus on low- or no-cost water services of the provision right to water raises serious concerns as to its ecologic sustainability.”<sup>105</sup> Similarly, water law expert Barton Thompson asserts “[p]ricing, markets, and even the participation of private entities have helped

---

101. See WWF-SA, *supra* note 81, at 20.

102. See, e.g., National Water Act 36 of 1998, § 56 (S. Afr.). For what it would look like to decommodify water, see Bond & Dugard, *supra* note 44, at 4.

103. National Water Act 36 of 1998, ch. 5.1 (S. Afr.).

104. Larson, *supra* note 5, at 2230.

105. *Id.* at 2235.

ensure that water is not wasted and, when properly directed and regulated, can help promote the environment and increase drinking-water access.”<sup>106</sup>

But there is a catch: companies—be they private companies or State-run companies such as Johannesburg Water Ltd. (discussed below)—have bought into the logic of neoliberalism, the belief that free markets handle resource distribution better than meddling governments, and that commodifying all resources leads to their more efficient distribution.<sup>107</sup> Neoliberalism suggests that even government agencies should earn their profits or recoup budgets through charging for water. But because they must make the spreadsheets balance out, government agencies have perverse incentive to increase revenue by encouraging *greater* water use. So, for example, Johannesburg Water Ltd. charges high, difficult to afford prices in the water pricing bracket just above basic use, and fail to set higher prices in the “hedonistic” gluttonous use practice.<sup>108</sup> This results in a lose-lose strategy: poor people cannot afford to pay for basic water beyond the (too low) twenty-five daily liters per person, while rich people have no incentive to conserve. These policies not only violate statutes and constitutional provisions marrying equity to ecology, they foster a system designed to maximize, not conserve, water use.<sup>109</sup>

South African water managers in the late 1990s saw some aspects of this as they drafted the White Paper and National Water Act. These documents walk a delicate line between neoliberal economics, human rights and equity, and a broader vision of ecological management. The documents see water provision not merely as an economic problem, but as an environmental problem. While the vision of those documents has not been fully realized, more recent documents (analyzed below) marry economic, human rights and ecological approaches to the right to water. In so doing, they come closer to satisfying the exigencies of what government officials must do to respect, protect, and fulfill the right to water, and to execute their public trust responsibilities.

## II.

### SOUTH AFRICA AND THE PUBLIC TRUST DOCTRINE: MARRYING EQUITY TO ECOLOGY

#### A. Introduction

This Paper bookends its descriptions of South Africa “getting it right” on the right to water by analyzing four documents. Two emerged shortly after independence: the 1997 White Paper on a National Water Policy for South

---

106. Thompson, *supra* note 91, at 19.

107. For a discussion of neoliberalism in the ESC rights context, see Kotzé & Bates, *supra* note 13, at 248; O’Connell, *supra* note 16, at 534–40.

108. See, e.g., Bond & Dugard, *supra* note 44, at 6; Lucy A. Williams, *The Justiciability of Water Rights: Mazibuko v. City of Johannesburg*, 18 WILLAMETTE J. INT’L L. & DIS. RES. 211, 245 (2010).

109. See WILSON & PEREIRA, *supra* note 80, at 17.

Africa and the 1998 National Water Act.<sup>110</sup> Two are more recent: the 2013 revised National Water Resources Strategy and the 2014 Water as Ecological Infrastructure Strategic Integrated Project.<sup>111</sup> These visionary documents present a holistic view of the role of water in community life. They ground the Public Trust Doctrine—legally and scientifically—in the ecological matrix that supports all life. They combine this with a fundamental commitment to righting past discriminatory wrongs; water is the centerpiece that links equity to ecology. If the government implemented the promises in these documents, it would provide a remarkable, deeply equitable law and policy framework that would provide a pathway—indeed, the only realistic pathway—to realizing the human right to water for all citizens.

The emerging framework for managing water in South Africa begins with the Public Trust Doctrine, which delineates a government's responsibility to manage and steward essential resources sustainably. It adds the constitutional (and internationally proclaimed) human right to an entitlement of water required for a dignified life<sup>112</sup> is grounded in a particular historical understanding of what equity really means, derived from a recent history that epitomized state-sponsored repression. While the White Paper on a National Water Policy calls this conception of the Public Trust Doctrine “uniquely South African,”<sup>113</sup> it nonetheless provides a model for citizens everywhere to enjoin their governments to conceive of their public trustee role as one that they can only fulfill through action based on deeply equitable principles.

On the path to implementing in law the constitutional mandate that “[e]veryone has the right to have access to...sufficient food and water,”<sup>114</sup> South Africa produced a visionary White Paper on Water Policy in 1997, which laid the groundwork for the 1998 National Water Act (“NWA”).<sup>115</sup> The 1997 White Paper prepared the foundation for reinstituting the Public Trust Doctrine. It noted that “[i]n Roman law (on which South African law is based) rivers were viewed as resources which belonged to the nation as a whole and were available for common use by all citizens, but were controlled by the state in the public interest. These principles fit in well with African customary law which saw water as a common good used in the interest of the community.”<sup>116</sup> The White Paper proclaims:

---

110. National Water Act 36 of 1998, ch. 5.1 (S. Afr.); DEP'T OF WATER AFFAIRS & FORESTRY, *supra* note 11.

111. DEP'T OF WATER AFFAIRS, NATIONAL WATER RESOURCE STRATEGY, *supra* note 20; SANBI, A FRAMEWORK FOR INVESTING IN ECOLOGICAL INFRASTRUCTURE IN SOUTH AFRICA (2014).

112. S. AFR. CONST., 1996, § 10 (“Everyone has inherent dignity and the right to have their dignity respected and protected.”).

113. DEP'T OF WATER AFFAIRS & FORESTRY, *supra* note 11, at § 5.1.2.

114. S. AFR. CONST., 1996, § 27, subsec. 1(b).

115. National Water Act 36 of 1998 (S. Afr.); DEP'T OF WATER AFFAIRS & FORESTRY, *supra* note 11.

116. DEP'T OF WATER AFFAIRS & FORESTRY, *supra* note 11.



The recognition of Government's role as custodian of the 'public trust' in managing, protecting and determining the proper use of South Africa's water resources . . . is a central part of the new approach to water management. As such it will be the foundation of the new water law. The main idea of the public trust is that the national Government has a duty to regulate water use for the benefit of all South Africans, in a way which takes into account the public nature of water resources and the need to make sure that there is fair access to these resources. The central part of this is to make sure that these scarce resources are beneficially used in the public interest.<sup>117</sup>

The 1998 National Water Act translates the principles of the Public Trust Doctrine into statutorily imposed duties, declaring that the National Government will be "the public trustee of the nation's water sources" and must "ensure that water is protected, used, developed, conserved, managed and controlled in a sustainable and equitable manner, for the benefit of all persons and in accordance with its constitutional mandate."<sup>118</sup>

Labeling water as a human right adds weight on one side of the balance when governments evaluate public trust duties against other pressing needs. When the right to water is named in the South African Constitution and implemented in law, it gives citizens greater ability to claim their rights, gives government greater responsibility to safeguard them, and gives courts greater latitude to police government conduct. When legislators and water managers disinterred South Africa's Public Trust Doctrine, they supplied a time tested (over fifteen hundred years) legal rationale for protecting these resources that adds further legal gravitas for the public to demand that the government steward vital resources responsibly.<sup>119</sup> Private parties must never be allowed to accrue and squander these resources.

In addition to tying the ancient Public Trust Doctrine to a more novel human rights concept, reawakening the Public Trust Doctrine provides additional ideological and legal support for the government's assertion of control over environmental resources, to which a nation's citizens have new, constitutionally mandated, and judicially reinforced fundamental human rights. While drawing on the doctrine's hoary history for legitimization, the White Paper's authors nonetheless stated that "the idea of water as a public good will be redeveloped into a doctrine of public trust which is uniquely South African . . ."<sup>120</sup>

---

117. *Id.* at § 5.1.2.

118. National Water Act 36 of 1998, ch.1 § 3(1) (S. Afr.).

119. This is the essential message of MARY CHRISTINA WOOD, *NATURE'S TRUST: ENVIRONMENTAL LAW FOR A NEW ECOLOGICAL AGE* (2014) and the seminal work of Joseph L. Sax, *The Public Trust Doctrine in Natural Resource Law: Effective Judicial Intervention*, 68 MICH. L. REV. 471, 484 (1970); David Takacs, *The Public Trust Doctrine, Environmental Human Rights, and the Future of Private Property*, 16 N.Y.U. ENVTL. L.J. 711, 713–15 (2008).

120. DEP'T OF WATER AFFAIRS & FORESTRY, *supra* note 11, at § 5.1.2; *see also* The National Environmental Management Act 107 of 1998, ch. 1. § 2, subsec. 4(o) (S. Afr.). (reaffirming the Public Trust Doctrine as the governing ideology for all natural resources: The "environment is held in public trust for the people. . .the beneficial use of environmental resources must serve the public interest and the environment must be protected as the people's common heritage.").

To do so, the White Paper grounds the Public Trust Doctrine in considerations of equity—a concept that had been in vicious retreat in the preceding centuries in South Africa—and to a revitalized concept of environmental democracy.<sup>121</sup> The democratic rights the Public Trust Doctrine (ideally) invests in each citizen to defend the Trust dovetail powerfully with procedural rights guaranteed by the post-apartheid Constitution.<sup>122</sup> The Public Trust Doctrine helps effectuate citizens’ constitutional right to “[j]ust administrative action,”<sup>123</sup> to court access,<sup>124</sup> and “access to information.”<sup>125</sup> These rights, when applied to environmental issues, foreshadow and help establish emerging Environmental Democracy customary international law principles, including the right to participate in environmental decision making, the right to access to information to make that participation effective, and the right to redress and remedy when these principles are violated.<sup>126</sup> The Public Trust Doctrine is not just a prescription for how governments must manage natural resources; it is also a prescription for how governments must honor citizens’ rights to participate in an environmental democracy.<sup>127</sup> In the words of Joseph Sax, naming a resource to the public trust means citizens can defend their trust rights in court “as a claimant of rights to which he is entitled,” namely wise stewardship of a shared resource.<sup>128</sup> As Mary Cristina Wood expressed, “[t]he public trust can inspire a narrative that imbues citizens with a firmer sense of legal standing toward their government. . . the trust identifies citizens as beneficiaries holding a *public property right* to crucial natural assets. . . This common property right postures citizens to monitor the commonwealth and empowers them to demand enforcement of their collective trust.”<sup>129</sup>

The new democracy in South Africa also required reconsidering how natural resources have been allocated. Twentieth century water rights in South Africa were tied to land ownership, which was codified in an aggressively racially discriminatory way. As the White Paper frankly acknowledges, “many of the Country’s previous water projects were built to serve the interests of a

---

121. See Takacs, *supra* note 121, at 717–18.

122. It should be noted that various experts I consulted with in South Africa suggested those procedural rights are currently under great threat from restrictive government policies.

123. S. AFR. CONST., 1996, § 33(1) (“Everyone has the right to administrative action that is lawful, reasonable, and procedurally fair.”).

124. “Everyone has the right to have any dispute that can be resolved by the application of law decided in a fair public hearing before a court [“or impartial forum or tribunal”]. . .” *Id.* at § 34.

125. “Everyone has the right of access to— (a) any information held by the state; and (b) any information that is held by another person and that is required for the exercise or protection of any rights.” *Id.* § 32(1).

126. David Takacs, *Environmental Democracy and Forest Carbon (REDD+)*, 44 LEWIS & CLARK ENVTL. L. 71 (2014).

127. Wood, *supra* note 121, at 272–76 (2014).

128. Larson, *supra* note 5, at 2248–49; Sax, *supra* note 121; Takacs, *supra* note 121. Rhett Larson suggests that the *Mazibuko* plaintiffs could have argued that the prepaid water provisions violated them of their public trust property and participation rights.

129. Wood, *supra* note 121, at 272–73.

minority of water users within what was already a privileged minority of the Country's population."<sup>130</sup> When apartheid was abolished the government should have also abolished its system of managing access to land and water.<sup>131</sup>

Situating the Public Trust Doctrine as a return to a legal regime that was impermissibly ignored during apartheid helps the government avoid takings claims when revoking water rights from citizens. While the Constitution's § 25 supports private property rights and the government can only take property "for a public purpose or in the public interest," compensation may be denied or reduced if the rights were given under apartheid. Because the "public interest includes the nation's commitment to land reform, and to reforms to bring about equitable access to all South Africa's natural resources,"<sup>132</sup> owners who acquired private property during apartheid may have no rights to keep that property, as "[n]o provision of this section may impede the state from taking legislative and other measures to achieve land, water and related reform, in order to redress the results of past racial discrimination."<sup>133</sup> The National Water Act thus institutes "compulsory licensing"<sup>134</sup> for water allocations; the government may forbid even previously approved allocations if they are not used in the public interest, and/or to fulfill basic human rights, and/or if the water "rights" were impermissibly granted in the first place, thus "redressing the results of past racial discrimination."<sup>135</sup>

Such allocations may have been illegitimate not only because they were deeded under an illegal apartheid system, but because that system itself revoked the use of the Public Trust Doctrine, which should have existed in common law in South Africa's Roman-derived legal system. Implementing the Public Trust Doctrine may constrain not only what private property owners may do with their property, but it may also define whether or not it is really their property at all. Declaring that the Public Trust Doctrine will guide all water decision making puts property owners on notice that their "rights" may be ephemeral: they are usufruct, revocable rights that must incorporate the interests of others.<sup>136</sup> By declaring that in South Africa the Public Trust Doctrine should have always obtained, the current government can now say that those in power during apartheid abandoned their duties as public trustees, and government actions taken during those years which violated the Public Trust Doctrine were illegal. Coupling the Public Trust Doctrine with § 25 of the new constitution—elaborated in the water law and policy documents discussed below—sets the

---

130. DEP'T OF WATER AFFAIRS & FORESTRY, *supra* note 11.

131. Robyn Stein, *Water Law in a Democratic South Africa: A Country Case Study Examining the Introduction of a Public Rights System*, 83 TEX. L. REV. 2167, 2168–70 (2005).

132. S. AFR. CONST., 1996, § 25(4)(a).

133. *Id.* at § 25(8).

134. National Water Act 36 of 1998, ch. 4.1 (S. Afr.).

135. DEP'T OF WATER AFFAIRS & FORESTRY, *supra* note 11, at § 5.1.3.

136. Sax, *supra* note 121, at 162; Takacs, *supra* note 121, at 722, 768; Barton, *supra* note 120, at 40.

stage for the government to fulfill its public trust responsibilities by transferring currently held water “rights” to fulfill the statutorily delineated needs of the ecological Reserve, which in turn forms the basis for fulfilling the human right to water for present and future generations.

According to Van der Schyff & Viljoen, although the concept of the Public Trust Doctrine “entered the South African legal realm without much fanfare, it changed the foundation of the water law dispensation in totality.”<sup>137</sup> This statutory basis helps put foundations under a doctrine that some jurists find fuzzy, vague, and ill-conceived.<sup>138</sup> Van der Schyff & Viljoen state that “the concept of public trusteeship as it is embodied in the NWA describes a utopia” which, alas, confronts “an unfailing truth—in this broken reality we call ‘Now.’”<sup>139</sup> These scholars also note that whereas the Public Trust Doctrine exists in other legal systems as common law, in South Africa it has been statutorily introduced, which may limit its scope.<sup>140</sup> However, the 1998 National Environmental Management Act invokes the Public Trust in a more expansive way: “[t]he environment is held in public trust for the people, the beneficial use of environmental resources must serve the public interest and the environment must be protected as the people’s common heritage.”<sup>141</sup> Because “the environment” in its entirety rests in the public trust, when coupled with the § 24 broad rights to a healthy environment,<sup>142</sup> the Public Trust Doctrine conveys a very powerful potential that has not yet been realized by jurists in South Africa, but is being used by those shaping the nation’s water policy in a visionary way, as we will see below.

### III.

#### THE RESERVE

The 1997 White Paper on Water Policy notes, “South Africa’s water law applied the rules of the well-watered colonizing countries of Europe to the arid and variable climate of South Africa.”<sup>143</sup> That is to say, the nation built its apartheid-era water strategies on not only a heinous social policy, but also on a

---

137. E. van der Schyff & G. Viljoen, *Water and the Public Trust Doctrine – a South African Perspective*, 4(2) TD: J. FOR TRANSDISCIPLINARY RESEARCH IN SOUTHERN AFRICA 339 (2008).

138. Takacs, *supra* note 121, at 733. For a recent take down from the “Darth Vader of the Public Trust Doctrine,” see James L. Huffman, *Why Liberating the Public Trust Doctrine Is Bad for the Public*, 45 LEWIS & CLARK ENVTL. L. 337, 338 (2015).

139. Schyff & Viljoen, *supra* note 139, at 353.

140. *Id.* at 346.

141. The National Environmental Management Act 107 of 1998, § 2, subsec. 4(o) (S. Afr.); *see also*, Michael C. Blumm & Rachel D. Guthrie, *Internationalizing the Public Trust Doctrine: Natural Law and Constitutional and Statutory Approaches to Fulfilling the Saxon Vision*, 45 U.C. DAVIS L. REV. 741, 791–92 (2012) (noting that additional statutes in South Africa extend the Public Trust Doctrine “well beyond tidal waters and shorelands to include sensitive ecosystems, wetlands, biological diversity and genetic resources, and mineral and petroleum resources.”).

142. S. AFR. CONST., 1996, § 24.

143. DEP’T OF WATER AFFAIRS & FORESTRY, *supra* note 11.

grievous ecological misrepresentation by the laws of humans which ignored the laws of nature, as so often occurs. To implement the new constitutional mandate that “[e]veryone has the right to have access to . . . sufficient food and water,”<sup>144</sup> authors of the foundational documents on South African water management opted instead to view the problem of water provision for present and future generations as essentially an environmental problem; they sought to situate the law of water in an appropriate ecological milieu.

The founding water documents introduced the necessity of an ecological “Reserve.” The White Paper is explicit: “After providing for the basic needs of citizens, the only other water that is provided as a right, is the Environmental Reserve—to protect the ecosystems that underpin our water resources, now and into the future.” One of the “Fundamental Principles for a new water law for South Africa” continues: “[t]he quantity, quality and reliability of water required to maintain the ecological functions on which humans depend shall be reserved so that the human use of water does not individually or cumulatively compromise the long term sustainability of aquatic and associated ecosystems.”<sup>145</sup> Another Principle puts the Reserve on equal footing with human water provision: “[t]he water required to meet the basic human needs. . . and the needs of the environment shall be identified as the Reserve and shall enjoy priority of use by right. The use of water for all other purposes shall be subject to authorization.”<sup>146</sup> Thus, the White Paper entwines human rights with ecological conservation by prioritizing both equally, as the newly revived Public Trust Doctrine would demand.

Furthermore, “[i]t is the duty of national Government, as part of its public trust function. . . to assess the needs of the Environmental Reserve and to make sure that this amount of water, of an appropriate quality, is set aside.”<sup>147</sup> And, resolutely: “[w]here the needs of the Environmental Reserve cannot be met because of existing developments, provision must be made for active intervention to protect the water resources.”<sup>148</sup> That is not merely a helpful suggestion. It clearly imposes concrete obligations on the public trustee. At first glance, this requires a precarious balancing act: provide basic water to all citizens, but do so in way that sustains the resource for present and future generations.<sup>149</sup> But lawmakers intertwined an expansive vision of how to maximize scarce hydrological resources for present and future generations with a profound view of what law must require of the public trustee charged with stewarding a resource.

---

144. S. AFR. CONST., 1996, § 27(1)(b).

145. DEP’T OF WATER AFFAIRS & FORESTRY, *supra* note 11, app. 1 principle 8.

146. *Id.* app. 1 principle 10.

147. *Id.* § 5.2.2.

148. *Id.*

149. Lee Godden, *Water Law Reform in Australia and South Africa: Sustainability, Efficiency and Social Justice*, 17 J. ENVTL. L. 181, 202 (2005).

The National Water Act, “widely considered to be one of the world’s most progressive water policies on paper,”<sup>150</sup> codified the White Paper’s vision, using the § 25 powers of the Constitution to abolish all private water allocations as a derogation of the public trust. All private water became public.<sup>151</sup> The Act points out, “[t]he basic human needs Reserve provides for the essential needs of individuals served by the water resource in question and includes water for drinking, for food preparation and for personal hygiene. The ecological Reserve relates to the water required to protect the aquatic ecosystems of the water resource.”<sup>152</sup> The management strategy must meet “the requirements of the Reserve,”<sup>153</sup> including “the ecological Reserve,” i.e. “the water required to protect the aquatic ecosystems of the water resource.”<sup>154</sup> South Africa is fortunate to have excellent mapping data that provides fine scale analysis of its ecological resources.<sup>155</sup> The Water Minister must use these resources to determine the Reserve for all areas of the country, and “[o]nce the Reserve is determined for a water resource, it is binding”<sup>156</sup> and carries legal responsibilities to sustain that Reserve. Water allocations must account for the needs of the Reserve and water use charges must consider costs of protecting the Reserve.<sup>157</sup> The Reserve, thus, is the legal and ecological cornerstone of South African water policy; the National Water Act recognizes that it can be no other way. As a result, the public trustee has the supporting legal structure as well as the tools to fulfill the directive to manage the Reserve for present and future needs of human and nonhuman communities, and is required to do so.<sup>158</sup>

The National Water Act’s critics note that by committing to full cost-recovery and devolving power to local water managers who lack the financial knowledge and capacity to implement the vision, lawmakers undercut the equity goals they espouse.<sup>159</sup> Furthermore, despite the fact that experts assert that about a quarter of the available water must stay in waterways to support the Reserve and despite the fact that managers have been required to map the Reserve since

---

150. Francis, *supra* note 14, at 162.

151. National Water Act 36 of 1998, ch. 4 (S. Afr.).

152. *Id.* ch. 4, pt. 3, § 32.

153. *Id.* ch. 4, pt. 3, § 34.

154. *Id.* ch. 4, pt. 3, § 30.

155. John Dini & Jeffrey Manuel, INTERVIEW WITH DIRECTOR OF ECOLOGICAL INFRASTRUCTURE AT THE SOUTH AFRICAN NATIONAL BIODIVERSITY INSTITUTE AND DIRECTOR OF BIODIVERSITY INFORMATION AND PLANNING AT THE SOUTH AFRICAN NATIONAL BIODIVERSITY INSTITUTE (Cape Town, 2015).

156. National Water Act 36 of 1998, ch. 4, pt. 3, § 30 (S. Afr.).

157. *Id.* ch. 5, pt. 1, § 60, ch. 5, pt. 2, § 62, ch. 6, pt. 1, § 64, ch. 6, pt. 2, § 70.

158. To quote Kotzé & Bates, “the Reserve seeks to cement sustainability as the strategic foundation of South African water law and governance.” Kotzé & Bates, *supra* note 13, at 241.

159. Francis, *supra* note 14, at 164–69; *see also*, Local Government: Municipal Systems Act 32 of 2000 (S. Afr.) (further explains and devolves services, including free basic water provision, to local communities); SERI, TARGETING THE POOR? AN ANALYSIS OF FREE BASIC SERVICES (FBS) AND MUNICIPAL INDIGENT POLICIES IN SOUTH AFRICA (2013) (detailing the basic service provision and local governments), [http://seri-sa.org/images/Targeting\\_the\\_Poor\\_Nov13.pdf](http://seri-sa.org/images/Targeting_the_Poor_Nov13.pdf).

1998, the Reserve is still not fully identified and thus not fully functional.<sup>160</sup> The government stewards have not fulfilled their statutory or public trust mandates: more than sixty percent of rivers and wetlands are ecologically “threatened,” many critically so.<sup>161</sup> That is to say, the visionary aspirations of South African water law have yet to be fulfilled. And the judicial system has not necessarily helped South Africans realize their rights to water.

#### IV.

##### MAZIBUKO V. CITY OF JOHANNESBURG: GOING TO COURT TO ADJUDICATE THE RIGHT TO WATER

###### A. Introduction

Because South Africa is ahead of the curve on proclaiming, implementing, and enforcing the human right to water, what its government and courts do matters not just to its own citizens, but to communities beyond its borders. *Mazibuko v. City of Johannesburg* is the first case heard in the highest court of any nation that challenges the acceptability of how a government implements the human right to water. George McGraw notes that “[d]ue to the relative novelty of the water rights concept, however, standards set by national courts are also being adopted elsewhere. International tribunals increasingly borrow from this jurisprudence, and national courts have even begun to mimic each other.”<sup>162</sup> McGraw notes “nowhere in the world is the right to water more clearly protected by legislation where the minimum core has been explicitly referenced in jurisprudence and case law than South Africa, which may serve as a model for international replication.”<sup>163</sup>

Paul O’Connell argues that through a process of “judicial globalization,” courts everywhere are converging on a market-friendly, neoliberal interpretation of human rights provision, to the detriment of those whom human rights are meant to serve.<sup>164</sup> This is particularly worrisome for the right to water, where, as McGraw worries, “recent South African judgments will substantially weaken further enforcement of water rights, particularly regarding the minimum core. If this is the case, the practical universality of the standard may be compromised.”<sup>165</sup> The Constitutional Court in *Mazibuko* and in other South African ESC rights cases has largely deferred to the elected branches to determine the contours of the rights. I would argue that a jurisprudence policy of deferring to the elected branches, especially when those branches are not being particularly progressive, has great potential impacts beyond the tip of Africa.

---

160. DEP’T OF WATER AFFAIRS, NATIONAL WATER RESOURCE STRATEGY, *supra* note 20, at 843 (noting that this is the “most critical resource protection imperative that this be done.”)

161. *Id.* at 9.

162. McGraw, *supra* note 16, at 164.

163. McGraw, *supra* note 16, at 191.

164. O’Connell, *supra* note 16, at 538.

165. McGraw, *supra* note 16, at 165.

Unfortunately, the work of the South African Constitutional Court—the final arbiter for these decisions—has restricted access to socioeconomic rights protection, thus diminishing the transformative potential of the national Constitution.

### *B. Mazibuko Background*

Phiri is a township in Soweto (the largest of Johannesburg's suburbs with a population that is 98.5 percent Black) with many impoverished residents living in overcrowded conditions.<sup>166</sup> As is the case in many similar communities in South Africa, few households have in-home running water.<sup>167</sup> Johannesburg Water Ltd., the state-owned company responsible for delivering water to Phiri residents, was charged both with delivering a scarce resource to a growing population and with recouping its costs under a "full cost recovery" model.<sup>168</sup> Johannesburg Water claimed that whereas Sowetans consumed one-third to one-quarter of all water delivered by the company, only one percent of their revenue came from there; both because residents didn't pay their bills and because antiquated infrastructure lead to leaking pipes and other water waste.<sup>169</sup> To conserve water and recover expenses, the company instituted a plan where citizens who wanted water piped onto their property would have to install a prepaid water meter. However, after twenty-five liters per person of free basic water flowed, if the residents had not paid fees their water would be turned off with no advance notice.<sup>170</sup>

Phiri's service provider, Johannesburg Water, fit the government's model that responded to the World Bank's loan conditions. Government ministers pronounced the valuable role private corporations could play in water provision.<sup>171</sup> The government could not give away the water supply to foreign corporations, as this would blatantly violate the Public Trust Doctrine. However, some water providers outsourced operations to foreign multinationals. Johannesburg Water contracted operations of its antiquated water system to two multinational corporations, the United Kingdom's Northumbrian Water and France's Suez Lyonnaise, which implemented "demand side management," i.e. making sure consumption was limited and books were balanced.<sup>172</sup> While still obliged to provide twenty-five liters of free water per person, the companies

---

166. Magaziner, *supra* note 3, at 512–16.

167. Humby & Grandbois, *supra* note 22, at 526; Wesson, *supra* note 23, at 394.

168. Even though the State still ran the company, it was advised by international corporate actors, and cleaved to a corporate model where costs had to be recouped through charging customers. Daniels, *supra* note 57, at 63.

169. *Mazibuko v. City of Johannesburg* 2010 (4) SA 1 (CC) ¶ 12 (S. Afr.).

170. *Mazibuko v. City of Johannesburg* 2008 (4) All. SA 471 (Wit. Local Div.) ¶ 3 (S. Afr.); Wesson, *supra* note 23, at 395.

171. Daniels, *supra* note 57, at 66–67.

172. Bond & Dugard, *supra* note 44, at 5; Magaziner, *supra* note 3, at 524; Williams, *supra* note 110, at 229.



instituted “cost recovery” by installing prepaid water meters for any additional water and cut off supply when bills were unpaid.

Five Phiri residents sued the City of Johannesburg, along with Johannesburg Water and the Ministry of Water Affairs and Forestry. They alleged that the provision of six kiloliters per household per month—that is, roughly twenty-five liters per person per day or approximately two toilet flushes, according to Johannesburg Water—did not meet constitutional standards for the right to water, and asked that the amount be doubled. They further alleged that Johannesburg Water improperly calculated its formula of eight people per household, as the real figure of people per household was much higher.<sup>173</sup> Thus many residents, including the plaintiffs, were receiving even less than their guaranteed, but still insufficient, allotment of free basic water. Plaintiffs also alleged that the installation of prepaid water meters, which would shut off without notice if bills were not paid, was unconstitutional, violating provisions of the right to dignity (§ 7), equality (§ 9), and, of course, water (§ 27(b)).<sup>174</sup>

The lead plaintiff, Lindiwe Mazibuko, lived as part of a twenty-member family group that fell behind on their water debt, and thus had their water disconnected. Co-plaintiffs complained, *inter alia*, of the difficulties imposed by restricted water when caring for patients with HIV/AIDS and other illnesses.<sup>175</sup> They also asserted that two of the co-plaintiff’s residents had died because disconnection by a prepaid water meter meant that no water was available when their home caught fire.<sup>176</sup>

Plaintiffs also alleged discrimination: prepaid water meters were only installed in poorer communities, which were also primarily Black communities. Phiri was the first community to be subjected to the new policy.<sup>177</sup> In wealthier, predominantly White communities, prepaid water meters were not the norm, and where they were, Johannesburg Water gave citizens ample time to pay bills before disconnection; they offered no such latitude in Phiri.<sup>178</sup>

### C. *Mazibuko at the Trial Court: A Victory for the Right to Water*

Judge Moroa Tsoka’s High Court (i.e. the trial court) opinion<sup>179</sup> has been hailed as a landmark equity decision on the right to water.<sup>180</sup>

Advocates in the case, and Judge Tsoka’s response to them, present a model for how to ground “progressive realization” of an ESC right in empirical

---

173. Daniels, *supra* note 57, at 87.

174. Magaziner, *supra* note 3, at 532.

175. Williams, *supra* note 110, at 213.

176. Danchin, *supra* note 89.

177. Danchin, *supra* note 89.

178. Bond & Dugard, *supra* note 44, at 10.

179. *Mazibuko v. City of Johannesburg* 2008 (4) All. SA 471 (Wit. Local Div.) (S. Afr).

180. Malcolm Langford & Anna Russell, *Case Commentary: ‘Global Precedent’ or ‘Reasonable No More?’: The Mazibuko Case*, 19 WATER L. 73 (2008).

studies of what must be provided to satisfy life's basic requirements. In *Grootboom* and *Treatment Action Campaign* as well as in *Mazibuko*, the amicus curiae unsuccessfully lobbied for the courts to recognize a minimum core whose specification would provide firmer content to the given right, and give less wiggle room to defer to any government claiming to be "progressing," however slowly, to realize the given right.<sup>181</sup> As legal scholars have explained, the problem is that requiring "reasonable" progress to realize a right "provides an almost impermeable shield through which government's shortfalls are recast as successes and progress in the right direction."<sup>182</sup> As noted above, for the human right to water, experts can provide empirical figures as to how much a human needs to survive and thrive.<sup>183</sup> A court *could* find facts to justify a minimum core, assess whether in fact a nation has the resources to provide this minimum core, and require and supervise a plan to acquire the resources and/or deliver that core.

Judge Tsoka reasoned that decisions in *Grootboom* and *Treatment Action Campaign* did not reject a minimum core for the right to water.<sup>184</sup> Citing U.S. water expert Peter Gleick, as well as UN and NGO sources, Judge Tsoka found ample evidence to support claims that fifty liters per person per day was required for a dignified life, and ordered Johannesburg Water to double the amount of water it provided to this amount, in line with international legal standards. Judge Tsoka noted that "[i]t is undeniable that the applicants need more water than the twenty-five liters per person per day and that the respondents are able, within their available resources, to meet this need."

Judge Tsoka held that installing prepaid meters (which turn off for non-payment without warning after distributing the basic allotment) in poor Black areas, and not wealthy White areas, constituted discrimination: it is "not only unreasonable, unfair and inequitable, it is also discriminatory solely on the basis of colour."<sup>185</sup> This finding has been called "both novel and significant in the global context."<sup>186</sup>

The judge opined: "[t]o argue, as the respondents do, that the applicants will not be able to afford water on credit and therefore it is good" for applicants to go on prepayment meters is patronizing. That patronization sustained

---

181. Danchin, *supra* note 89. For an alternate, skeptical view of the minimum core (with additional references), see Margaux J. Hall & David C. Weiss, *Human Rights and Remedial Equilibration: Equilibrating Socio-Economic Rights*, 36 BROOK. J. INT'L L. 453, 469 (2011).

182. Hall & Weiss, *supra* note 181, at 480.

183. McGraw, *supra* note 16, at 199.

184. *Mazibuko v. City of Johannesburg* 2008 (4) All. SA 471 (Wit. Local Div.) at para. 133 (S. Afr.).

185. *Id.* para. 94. The UN Special Rapporteur on the Right to Water and Sanitation says that "authorities must ensure that the person faced with the disconnection must be given opportunities for consultation and for rectifying the situation" and "must be informed in advance, with reasonable notice, of the planned disconnection, recourse to legal remedies and legal assistance to obtain remedies." de Albuquerque, *supra* note 22, at 61.

186. Langford & Russell, *supra* note 180, at 77.

apartheid: its foundational basis was discrimination based on color and decisions taken on behalf of the majority of the people of the country as “‘*big brother felt it was good for them.*’”<sup>187</sup> Even more assertively, Judge Tsoka ruled that because women and girls do the bulk of water collection, Johannesburg Water’s policies constitute gender discrimination.<sup>188</sup>

Judge Tsoka forcefully argued that the Constitution demands that the government do more to fulfill the right to water—and to fulfill it without discrimination based upon class, race, or gender. Had the decision been upheld, it would have laid the groundwork for a more aggressive, proactive, holistic approach to providing water for all its citizens. It also would have served as a model for governments and courts everywhere on what governments must do to implement the right to water, and what courts should do to evaluate the government’s efforts.

#### D. *Mazibuko at the Constitutional Court*

As noted above, the South African Constitution provides a loophole on the right to water: progressive realization requires the state to “take reasonable legislative and other measures, within its available resources, to achieve the progressive realization of each of these rights.”<sup>189</sup> The Constitutional Court proved to be not all that progressive when discussing progressive realization in its internationally “seminal” decision on the right to water.<sup>190</sup> The *Mazibuko* court gave the government wide berth, asserting it had neither the wisdom nor the right to intervene, and found that the government had made an adequate case that it was making satisfactory progress in providing basic water to citizens of Soweto. Unlike in *Grootboom*, Johannesburg Water convinced the court it was taking reasonable steps to fulfill the rights of those most in need. Unlike in *Treatment Action Campaign*, the government was not acting irrationally and unreasonably according to its own stated policies and logic. The Court further noted that the City and its utility had doubled basic water provision to the poorest households. The court seemed particularly impressed that the government agency continuously examined and readjusted its policies; and, if such adjustment came as a result of the litigation, then that is one way to coerce a democratically accountable government to respond to citizen needs.<sup>191</sup>

---

187. *Mazibuko v. City of Johannesburg* 2008 (4) All. SA 471 (Wit. Local Div.) at para. 153 (S. Afr.).

188. *Id.* at para. 159. On appeal, an intermediate court subsequently lowered the daily requirement to 42 liters/person/day, but affirmed the unacceptability of the prepaid water meters, and gave the agency a two-year reprieve to meet the requirements. <http://www.saflii.org/za/cases/ZASCA/2009/20.html>.

189. S. AFR. CONST., 1996.

190. Rep. of the Human Rights Council on its Twenty-Seventh Session, ¶¶ 57-60, U.N. Doc. A/HRC/27/2 (Dec. 22, 2014).

191. *Mazibuko v. City of Johannesburg* 2010 (4) SA 1 (CC) at para. 96 (S. Afr.). “It may well be, as the applicants urge, that the City’s comprehensive and persistent engagement has been spurred by the litigation in this case. If that is so, it is not something to deplore. If one of the key goals of the

Despite the UN Committee on Economic, Social and Cultural Rights' and other experts' admonitions that governments are responsible for providing some minimum core of ESC rights, the Constitutional Court reiterated conclusions from *Grootboom* and *Treatment Action Campaign*: the Court held that human rights guaranteed in the Constitution do not require a "minimum core" to comprise fulfillment.<sup>192</sup> In rejecting a minimum core, the justices asserted that it would be "institutionally inappropriate for a court to determine precisely what the achievement of any particular social and economic right entails and what steps government should take to ensure the progressive realisation of the right."<sup>193</sup>

Instead, to evaluate a plan, policy, or program, the South African Constitutional Court created a "reasonableness" standard to judge whether measures taken for both the general public and the most indigent in society are acceptable.<sup>194</sup> If a plan is "comprehensive, coherent, balanced, flexible, and feasible," if it has a functional legal and administrative structure, and it does not exclude large segments of society, then it is "reasonable."<sup>195</sup> For indigent citizens, special "fast track" provisions must be implemented, with less margin of error given to the government. In *Mazibuko*, the Court found that the government met these requirements.<sup>196</sup> The Court concluded that progressive realization "requires the state to take reasonable legislative and other measures progressively to achieve the right of access to sufficient water within available resources. It does not confer a claim for 'sufficient water' from the state immediately."<sup>197</sup> Using these criteria, the Court found that the policy of providing twenty-five liters per person per day was reasonable, and deferred to the legislature and executive in setting disbursement amounts.<sup>198</sup>

International standards on the right to water demand that pricing of water services must be "based on the principle of equity, ensuring that these services, whether privately or publicly provided, are affordable for all, including socially disadvantaged groups. Equity demands that poorer households should not be disproportionately burdened with water expenses as compared to richer households."<sup>199</sup> To put it more bluntly, as Lucy Williams does, "in a water-

---

entrenchment of social and economic rights is to ensure that government is responsible and accountable to citizens through both the ballot box and litigation, then that goal will be served when a government respondent takes steps in response to litigation to ensure that the measures it adopts are reasonable, within the meaning of the Constitution. The litigation will in that event have attained at least some of what it sought to achieve."

192. *Id.* para. 53. For further commentary, see Magaziner, *supra* note 3, at 573; Thompson, *supra* note 91, at 77.

193. *Mazibuko v. City of Johannesburg* 2010 (4) SA 1 (CC) at para. 60 (S. Afr.).

194. Francis, *supra* note 14, at 189.

195. *Id.* at 188–89.

196. *Id.*

197. *Mazibuko v. City of Johannesburg* 2010 (4) SA 1 (CC) at para. 56 (S. Afr.).

198. *Id.* para. 9.

199. General Comment 15, *supra* note 34, ¶ 27.

deprived country, wealthier people should not be allowed to fill their swimming pools at relatively low cost while others die unnecessarily from AIDS-HIV because they do not have access to basic sanitation necessities such as enough water to wash themselves.”<sup>200</sup> South African critics allege the poverty line is set much too low, the bureaucracy of registering as an indigent is cumbersome, demeaning, and poorly administered, and only a fraction (in Johannesburg, an estimate of ten percent<sup>201</sup>) of the truly “indigent” end up registering.<sup>202</sup> Furthermore, White households in wealthy neighborhoods have unlimited water on credit<sup>203</sup> and other water debtors, including government agencies (which, in fact, had the worst record for non-payment of water bills<sup>204</sup>), did not face the same prepaid restrictions. Nonetheless, the Court held that the policy did not discriminate against poor, Black households in Phiri; because all poor Black communities did not have the prepaid water meters, the policy was not discriminatory.<sup>205</sup> Human rights lawyer Jackie Dugard has referred to this reasoning as “insane,” and “the most utterly outrageous and unacceptable of all the components of the judgment.”<sup>206</sup>

Furthermore, while a lower court in a separate case had found that disconnecting an existing water supply was a *prima facie* breach of the human right to water,<sup>207</sup> here the Court argued that when the municipality shuts off the water after failure to pay, this does not result in disconnection—rather, the “water. . . is suspended until either the customer purchases further credit or the new month commences with a new monthly basic water supply whereupon the water supply recommences. It is better understood as a temporary suspension in supply, not a discontinuation.”<sup>208</sup> To argue that shutting off a resident’s water when she cannot pay is not technically “disconnection,” seems to stretch its dictionary definition.<sup>209</sup>

200. Williams, *supra* note 110, at 246.

201. CENTRE ON HOUSING RIGHTS AND EVICTIONS, CASE STUDIES ON EFFORTS TO IMPLEMENT THE RIGHT TO WATER AND SANITATION IN URBAN AREAS: BRAZIL, KENYA, SRI LANKA, AND SOUTH AFRICA 37 (2008), <http://www.righttowater.info/wp-content/uploads/Case-Studies-on-Efforts-to-Implement-the-Right-to-Water-and-Sanitation-in-Urban-Areas-Brazil-Kenya-Sri-Lanka-and-South-Africa.pdf>.

202. SERI, *supra* note 161, at 44; Francis, *supra* note 14, at 189; Wesson, *supra* note 23, at 400; Williams, *supra* note 110, at 231.

203. Williams, *supra* note 110, at 235.

204. Bond & Dugard, *supra* note 44, at 11; Williams, *supra* note 110, at 245.

205. *Mazibuko v. City of Johannesburg* 2010 (4) SA 1 (CC) at paras. 148–57 (S. Afr.).

206. McGraw, *supra* note 16, at 198. Dugard has expressed similar sentiments to me during an interview.

207. *Residents of Bon Vista Mansions v. S. Metro. Local Council* 2002 (6) BCLR 625 (W) (S. Afr.). For further discussion, see Daniels, *supra* note 57, at 87.

208. *Mazibuko v. City of Johannesburg* 2010 (4) SA 1 (CC) at para. 119 (S. Afr.).

209. Recently, in cases where water was disconnected in poor people’s homes in Detroit, three UN experts weighed in that “when there is genuine inability to pay, human rights simply forbids disconnections.” *Detroit: Disconnecting Water From People Who Cannot Pay - An Affront to Human Rights, Say UN Experts* (June 25, 2014), <http://www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=14777>.

Finding that “[c]ourts are ill-placed to make these assessments for both institutional and democratic reasons,” the justices carved out a narrow purview for themselves as they deferred to the elected branches.<sup>210</sup> The Court abdicated responsibility to define what the right itself might actually mean. The Court did not challenge the World Bank’s neoliberal approach that pressures the government towards full cost recovery, even if that policy ends up wasting water. As Professor Pierre De Vos put it: “[t]he judgment seems to be based on an assumption that people do not pay for water because they are bad or dishonest people: they want something for free when they need to (and can) pay for the water. It fails to take account of the fact that even if we all wanted to be good little capitalists like the government wants us to be, we cannot all afford the basic necessities that would sustain our lives.”<sup>211</sup> The Court did not consider international or other evidentiary standards to constitute what counts as fulfillment of the right to water. It did not see the post-liberation nature of the Constitution as “transformational,” as scholars and activists have claimed, thus requiring special solicitude to promote justice and equity.<sup>212</sup>

Some scholars have commented that the *Mazibuko* Constitutional Court’s prudential modesty was, indeed, prudent. Defenders of the ruling have argued that a court order mandating a minimum core, or more rapid “progressive realization,” would not meet the realities of water managers’ lack of capacity. A court order that cannot be fulfilled threatens the Court’s legitimacy.<sup>213</sup> Some have argued that a court-ordered increase of the minimum core would “drastically undermine the fragile consensus and faith in the constitutional system of human rights on which the South African democracy is based” because municipalities would lack the resources to fulfill the order.<sup>214</sup> They assume that the agencies are acting as diligently as they can—when, in fact, the agencies had other choices available to them. Are the justices obliged to consider these available choices? When the needs of the poorest of the poor to the most fundamental basis for life is at stake, and when there is clear statutory directive to do so, the courts have a responsibility to do more probing analysis than the justices engaged in here.

The Court said it could not order the government to have more resources than exists. But can it? While “the human rights framework does not demand the impossible,”<sup>215</sup> according to Special Rapporteur on the Right to Water Catarina de Albuquerque, it requires more than what the courts in *Mazibuko* were willing to consider. Safeguarding separation of powers in a fledgling democracy is a worthy goal—but one that is not absolute, especially when it comes into conflict with competing views of what a court is for, which includes helping all citizens

---

210. *Mazibuko v. City of Johannesburg* 2010 (4) SA 1 (CC) at para. 61 (S. Afr.).

211. De Vos, *supra* note 23, at 3.

212. Bond & Dugard, *supra* note 44, at 4.

213. See, e.g., Humby & Grandbois, *supra* note 22, at 539–40.

214. *Id.* at 539; see Williams, *supra* note 110, at 215, 246.

215. de Albuquerque, *supra* note 33, ¶ 49.

acquire the fundamental basic resources that would allow them to participate meaningfully in that fledgling democracy.<sup>216</sup> The decision also comes at a cost of setting international legal standards that may result in ill health and death in South Africa and beyond. Scholars argue that “[t]he Constitutional Court’s subsequent repeal of [Judge Tsoka’s High Court] decision was so restrictive . . . that it has thrown into question the entire international consensus developed thus far.”<sup>217</sup>

Even if the justices are aware of their role as legal trendsetters, it is not the Constitutional Court’s responsibility to adjudicate for the rest of the planet. Nonetheless, the Court stopped far short of what it could have done to realize the transformational potential of the South African Constitution and examine the facts underlying the government’s lack of progress in progressive realization.

### *E. Progressive Realization and the Right to Water Redux*

The problem here is not simply that the Constitutional Court in *Mazibuko* made the wrong judgment, given the facts it was using and the law it applied to the facts. Rather, it is that all involved suffer from a myopic and misguided vision of what water is, what the right means, what is possible under “progressive realisation,” and what progress “within its available means” means. The law, quite simply, often gets the right to water wrong, and this paper seeks to right that wrong. Humby and Grandbois argue that “it is no use having beautifully-worded progressive laws on paper that are never enforced.”<sup>218</sup> That is a thesis of *this* paper, as well: the courts are not enforcing the law as written.

So what does “progressive realisation” “within its available means” mean when it comes to the right to water? Missing here, and missing in so much analysis (including the courts’ own analyses) of the right to water is consideration of ecological resources.

South African courts—even the more progressive and aggressive lower courts—fail to treat the right to water as an environmental problem. It is not only that the government could have made institutional arrangements so that local municipalities, to whom responsibility for water provision had been devolved, had sufficient financial and human resources to manage what they have been assigned,<sup>219</sup> or that the Constitutional Court derived baffling conclusions about equity and discrimination. It is not simply that Johannesburg Water could have pursued less restrictive, less discriminatory technological solutions. Poor infrastructure is all too common in South African water provision.<sup>220</sup> For example, leaks caused much of the water loss in Phiri’s antiquated water

---

216. Williams, *supra* note 110, at 249.

217. McGraw, *supra* note 16, at 196.

218. Humby & Grandbois, *supra* note 22, at 540.

219. See, e.g., Bond & Dugard, *supra* note 44, at 3; Danchin, *supra* note 89; Humby & Grandbois, *supra* note 22, at 529.

220. S. AFR. HUMAN RIGHTS COMM’N, *supra* note 30, at 14.

system.<sup>221</sup> Thirty-seven percent (and possibly more) of drinking water is lost through leaks, drips, and other faults of aging infrastructure, and it is estimated that the equivalent of 600,000 Olympic-sized swimming pools are lost annually through waste.<sup>222</sup> The agency likewise could have installed conventional water meters that gave notice before disconnection (and thus time to pay owed fees). In fact, these meters were largely used elsewhere—particularly in wealthy (predominantly White) communities.<sup>223</sup>

Even compared to the “reasonableness” standard of review in its previous ESC rights jurisprudence,<sup>224</sup> the *Mazibuko* court got it wrong. The government not only failed to take “reasonable” measures to provide simple technological fixes and “reasonable” measures to make equity fixes, it also failed to take “reasonable”—indeed, legally required—measures to protect the ecological infrastructure upon which water provision relies.

Nowhere in any of the three *Mazibuko* opinions does the word “Reserve” appear. It is not that the lawyers and judges lacked ecological imagination, or were relying on a somewhat squishy international consensus on what “progressive realization” means. As discussed above, the Reserve’s statutory prominence as a cornerstone of South African water law is unmistakable.

Nonetheless, several reasons may exist for why the Reserve and its purpose are absent in *Mazibuko*. First, plaintiffs may have seen it in their best interest not to remind the Court of the Reserve requirements. For example, plaintiffs may have believed that, at least in the short term, every liter kept in the Reserve was one less liter coming out of a standpipe in Phiri and elsewhere. Kotzé & Bates assert that “[h]ad the Constitutional Court answered the plea of Phiri’s poor in the way that most expected it would by confirming an increased quantity of free water per person, the effect might very well have been that socio-economic concerns outweighed ecological considerations. This arguably could have affected long-term sustainability, and would have ignored adherence to the dictates of the Reserve and the need to holistically view constitutional environmental and socio-economic entitlements.”<sup>225</sup> Of course, that does not absolve the Court of not discussing the Reserve and how it is managed. Furthermore, the presumption is false—only through managing the Reserve responsibly according to public trust responsibilities could Johannesburg Water provide a minimum core, as Kotzé & Bates recognize: “[w]hat is important is that the cumulative objectives of these rights and statutes be fully realized in a holistic and balanced way during their implementation.”<sup>226</sup>

---

221. Wesson, *supra* note 23 at 394–95.

222. Fioramonti, *supra* note 80; SIP 19, *supra* note 13, at 12; CDP, *Rising Water Risks -: Businesses Facing a New Reality: CDP South Africa Water Report*, at 22 (2013).

223. See, e.g., Bond & Dugard, *supra* note 44, at 3; Danchin, *supra* note 89; Wesson, *supra* note 23, at 404 (2011).

224. See, e.g., Kotzé & Bates, *supra* note 13, at 268.

225. *Id.*

226. *Id.* at 269.



More profoundly, lawyers and judges in South Africa and beyond suffer from an ecological myopia that leads to misunderstanding about what it would mean to fulfill public trust responsibilities, to sustainably steward the Reserve, and thus be able to fulfill the human right to water. For many lawyers and judges, water provision is a problem of economic efficiency, technological capacity, and government bureaucracy. They do not see water provisioning as an environmental problem. Even with limited state resources, sound management of the ecological Reserve would result in more water availability in the short and long term, as framers of the nation's water laws envisioned. But we would first have to understand that managing grazing, clearing invasive weeds, creating riparian buffer zones, and implementing similar strategies upstream would result in more, and better quality, of water downstream. We simply do not think about or understand that water coming out of the tap springs from natural sources in distant places. We are separated from our ecological roots, and that "we" includes urban lawyers and judges.

This criticism, however, is not meant to scapegoat South African jurists as the only experts whose imaginations are cramped when it comes to the right to water. For example, the UN's Special Rapporteur on the human right to water, Catarina de Albuquerque, has issued numerous reports fulfilling her mandate. While her work on the equity requirements of state responsibility for the human right to water is extensive and detailed, she barely discusses the human right responsibilities to manage the ecological sources of water. Even the internationally delegated expert scarcely views the human right to water scarcity as an environmental problem.

In two reports on "good practices," the Special Rapporteur dedicated only a single paragraph to "Environmental sustainability." The paragraph noted only that "water quality and availability have to be ensured in a way that respects and supports the larger environment."<sup>227</sup> The Rapporteur's "Compilation of good practices" contains nothing directly commenting on preserving water sources as a way to maximize and protect available water.<sup>228</sup>

The Special Rapporteur's report on "Common Violations of the Human Right to Water and Sanitation" dedicated two paragraphs to protecting water from damage, excessive exploitation, and contamination. She cited cases from France and the African Commission on Human and Peoples' Rights—focused on State responsibilities to "protect" through monitoring and preventing pollution.<sup>229</sup> The report shows no evidence that "failure to protect water distribution" may include a failure to manage the ecological matrix that generates and protects the water in the first place. Her extensive Annex on "robust indicators" for violations of the human right to water says nothing about

---

227. Catarina de Albuquerque (Special Rapporteur on the Human Right to Safe Drinking Water and Sanitation), *Progress Rep. on the Compilation of Good Practices*, U.N. Doc. A/HRC/15/31/Add.1 (July 1, 2010).

228. de Albuquerque, *supra* note 22.

229. de Albuquerque, *supra* note 33, at ¶¶ 29–30.

environmental or ecological management.<sup>230</sup> The lack of attention to ecological infrastructure may reflect that many of her examples are drawn from self-reporting. Namely, if a national court or government fails to view careless stewardship of the ecological reserve as a human rights issue, she has nothing to report.

In noting that the “obligation to ensure minimum essential levels of water and sanitation is considered an immediate obligation,” the Special Rapporteur cited the Committee on Economic, Social and Cultural Rights as noting that States “must demonstrate that every effort has been made to use all resources that are at its disposition in an effort to satisfy, as a matter of priority, those minimum obligations.”<sup>231</sup> However, the requirement to steward the source of those resources is not mentioned. Even more perplexingly, in a report “[f]ocusing on sustainability in the realization of the human rights to water and sanitation,”<sup>232</sup> the Special Rapporteur spends only two paragraphs rehashing bromides on sustainable development without any specific application of how these generalities apply to state responsibility for the human right to water.<sup>233</sup> Finally, in a nine-booklet “handbook” on “Realizing the human rights to water and sanitation” and a one hundred and fourteen page compendium of “best practices,” which represents a culmination of her work, the Special Rapporteur only tangentially mentions environmental sustainability. Thus, sustainability largely remains a neglected part of her mandate.<sup>234</sup> These omissions demonstrate that South African jurists are not the only legal experts missing the environmental components of the fundamental human right to water.

Further damage comes from unlinking economy to ecology. If we subscribe to the logic of full cost recovery, then gluttonous users should be charged rapacious prices to discourage overconsumption and preserve the Reserve. Bond & Dugard consider “imposing a luxury consumption charge” as part of a program of “decommodifying” water, both to discourage consumption and to subsidize those who cannot afford a dignified amount of free basic water.<sup>235</sup> But full cost recovery means that the utility has perverse incentives to encourage more water use from paying customers. And indeed, Johannesburg Water was charging relatively low rates for the highest (“luxury”) use group, and those rates were flat for all people using over fifty kiloliters per month.<sup>236</sup> Regrettably,

---

230. *Id.* at 26–28.

231. *Id.* ¶¶ 29, 49 (citing Committee on Economic, Social and Cultural Rights, General Comment No. 3, para. 10).

232. Catarina de Albuquerque (Special Rapporteur on the Human Right to Safe Drinking Water and Sanitation), *Rep. of the Special Rapporteur*, U.N. Doc. A/HRC/24/44, summary (July 11, 2013).

233. *Id.* at ¶¶ 18–19.

234. *See* DE ALBUQUERQUE, *supra* note 5.

235. *See* Bond & Dugard, *supra* note 44, at 4–5 (2008); Danchin, *supra* note 89.

236. *See, e.g.,* Bond & Dugard, *supra* note 44, at 6; Williams, *supra* note 110, at 245.

the amalgamation of these factors led to the sacrifice of a potential source of both revenue and water conservation.<sup>237</sup>

Thus, this Paper contends that advocates and judges in South Africa and elsewhere are taking a myopic view of which facts matter in assessing “reasonable” progressive realization of the right to water. It is not simply that they are failing to look at basic technological solutions (fixing leaks) or failing to assess the facts of equity (installing prepaid water meters in Black areas only indicates that something is amiss). Much more fundamental and grave is that they are failing to consider facts about proper trusteeship of ecological infrastructure.

Yet South African jurists *are* capable of seeing that environmental needs and human needs are interrelated, and that sustainable development means sustaining the resource base that undergirds all human communities. Indeed, in a remarkable 2007 discussion in *Fuel Retailers Association of Southern Africa*,<sup>238</sup> the Constitutional Court engaged in an extensive discussion of international law, thereby underpinning the right to ecologically sustainable development. The Court acknowledged that “[i]t is in the light of these developments in the international law of environment and sustainable development that the concept of sustainable development must be construed and understood in our law.”<sup>239</sup> When considering the Constitution’s guaranteed right to a healthy environment, the Court noted: “. . . The need for development must now be determined by its impact on the environment, sustainable development and social and economic interests. The duty of environmental authorities is to integrate these factors into decision-making and make decisions that are informed by these considerations.”<sup>240</sup>

However, such a lofty conclusion would not subsequently translate into a proactive understanding of what it would mean to enforce this legal logic when adjudicating implementation of the human right to water. The *Fuel Retailers* Court concluded that “[o]ur Constitution does not sanction a state of normative anarchy which may arise where potentially conflicting principles are juxtaposed. It requires those who enforce and implement the Constitution to find a balance between potentially conflicting principles.”<sup>241</sup> And in *Mazibuko*, no conflicting principles needed be juxtaposed. It need not have come down to a conflict (or even “normative anarchy”) between ordering more water for human life and dignity, versus threatening a fragile democracy. Progressive realization of the right to water to the maximum of available resources could and should have

---

237. See, e.g., Bond & Dugard, *supra* note 44, at 6; Williams, *supra* note 110, at 245.

238. *Fuel Retailers Ass’n of S. Afr. v. Director-General Env’tl. Mgmt.* 2007 (10) BCLR 1059 (CC) at para. 79 (S. Afr.) (Sachs, J., dissenting). The case, ironically, was brought by existing fuel dealers who wanted to prevent another service station from opening nearby.

239. *Id.* ¶ 56.

240. *Id.* ¶ 79.

241. *Id.* ¶ 93.

included the very environmental considerations the court acknowledged in *Fuel Retailers*.

Given that water is the basis for all life, this myopia remains all the more startling. Many actors seem to suffer from tunnel vision, along with a lack of creativity and fundamental ecological literacy when thinking about what it would mean to realize the right to water. South Africa is a developing country with limited means and overwhelming societal demands; its glaring social, racially coded inequality and devastating history provides the infrastructural inequality context for all discussions of the right to water and all other rights. Courts there should be taking a much harder look at all the facts underlying progressive realization of the right to water (and other ESC rights).

Given this context, an entity fails the “reasonable test” for progressive realization not only if it disproportionately penalizes the most indigent members of society (as Johannesburg Water seemed to do in *Mazibuko*), but also if it fails to heed its legally mandated public trust responsibilities to manage the Reserve. The South African government and its water providers violated the Public Trust Doctrine in various ways in the *Mazibuko* case. Or it would be so if the courts had even considered the possibility. The Public Trust Doctrine—which, by law, governs water management in South Africa—means the government is charged with sustaining the resource’s ecological source for present and future generations of humans and nonhumans. The White Paper and the National Water Act understand this right; the courts get it wrong. None of the three *Mazibuko* courts mention the Public Trust Doctrine, the guiding principle by which water must be managed. None mention the Reserve, the preservation of which takes equal precedence in the National Water Law with the need to provide basic water to all citizens.

If, according to § 27(2) of the Constitution, the government must “take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of” the right to water, then we must interrogate what the phrase “available resources” actually entails.

First, the government is not working “within its available resources” to progressively realize the human right to water when it fails to look at equity solutions, particularly those tied to the Public Trust. Looking at “available resources” requires considering a variety of facts. For one, irrigated agriculture uses sixty percent of available water.<sup>242</sup> Second, ninety-five percent of irrigated farming is used by White-owned, large-scale industrial farmers,<sup>243</sup> yet irrigated farming constitutes only three percent of the nation’s GDP and creates only seven percent of the nation’s jobs.<sup>244</sup> On the other hand, three percent of farms

---

242. DEP’T OF WATER AFFAIRS, NATIONAL WATER RESOURCE STRATEGY, *supra* note 20, at iii.

243. Daniels, *supra* note 57, at 64.

244. DEP’T OF WATER AFFAIRS, NATIONAL WATER RESOURCE STRATEGY, *supra* note 20, at 8; Daniels, *supra* note 57, at 64.

produce ninety-five percent of the country's formal food sector.<sup>245</sup> More water could be available by prioritizing water for the truly productive farms and diverting water from unproductive uses. Furthermore, South Africa wastes thirty to forty percent of its food; more resources, including water, would be made "available" if the nation reduced this spectacular waste.<sup>246</sup> In the food sector, lack of equity meets lack of ecology in a particularly egregious way—one that shows a clear lapse in government public trust responsibilities and failure to respect the government's own belief in water as an economic commodity.<sup>247</sup>

Moreover, the government provides most of the water for irrigation at no cost.<sup>248</sup> As such, this industry uses nearly another twenty percent of South Africa's available water.<sup>249</sup> Johannesburg Water had chosen a flat rate for the industrial sector as well, thus discouraging conservation and decreasing cross subsidies for poor users. Even with the World Bank-imposed logic of full cost recovery, managers could be charging much more to the sixty thousand or so business purchasers of water,<sup>250</sup> and/or to water gluttons who can either afford to pay or who would be compelled to conserve when the price is too high, thereby increasing the quantity of and access to available water resources to the most indigent.

But water managers cannot simply mismanage the resource and respond that the remaining water is all the water that is "available." By squandering the resource, including allowing it to be arrogated to private concerns—despite the Constitution and prior statutes' clear authority mandating otherwise—and failing to manage the Reserve in violation of clear requirements, the government violates its public trust responsibilities. In so doing, agencies fail to effectively manage their resources, thereby violating § 27(b) and international standards on the right to water.

In the long run, arguments over the proper standards for fulfilling the right to water—e.g., minimum core test vs. reasonableness test—become irrelevant if the government fails to take seriously its public trust responsibilities in the first place. A State cannot have progressive realization to the maximum of available resources if it is minimizing such resources. It cannot provide a minimum core—or the core is going to be quite minimal—if it is not managing the Reserve. It becomes evident that in more recent documents, the government concedes that it has failed to sustainably manage the Reserve, as it is statutorily required to do. Despite this awareness, the government instead chooses to

---

245. WWF-SA, *supra* note 81, at 5.

246. See generally, David Oliveira, *Food waste costs SA R61.5-billion a year*, ENGINEERING NEWS, <http://www.engineeringnews.co.za/article/food-waste-costs-sa-r615-billion-a-year-2013-08-23>.

247. WWF-SA, *supra* note 81, at 4.

248. Michael Kidd, *Poisoning the Right to Water in South Africa: What Can the Law Do?*, 1 INT'L J. RURAL L. & POL'Y, at 8 (Spec. Ed. 2011).

249. See, e.g., Williams, *supra* note 110, at 245.

250. Interview with Mark Botha, Lecturer, University of the Western Capie, in Scarborough, South Africa (Feb. 17, 2015).

continue dissipating the resource it is legally obliged to steward. The courts in *Mazibuko* certainly had it within their legal purview to look at how government agencies were fulfilling their public trust responsibilities by stewarding or failing to steward the Reserve—the source of all water.

It is frustrating that South Africa has all the ingredients to get the right to water correct. It possesses the ability to fulfill progressive realization much more progressively—“progressively” as in making more progress in fulfilling the right, doing it in a visionary and equitable way, and leading the way to this fundamental right internationally. It also has a transformative Constitution with clear guarantees on the right to water and other environmental rights, the right history to compel equity, the appropriate statutes implementing the right, and the excellent mapping and technological expertise to prioritize protections.

And, despite the disappointing ruling in *Mazibuko*, South Africa is refining its legal tools for progressive realization of the right to water, as discussed in the next Section.

## V.

### GETTING THE RIGHT TO WATER AGAIN

Litigation may not be the most effective way to realize the human right to water in South Africa.<sup>251</sup> Despite the Constitutional Court’s reluctance to enforce the right to water more aggressively, South Africa has presented a deeply equitable vision for how to implement the human right to water. In four documents spanning seventeen years, lawmakers and policymakers have presented a blueprint for how government can and must fulfill its public trust responsibilities to protect the human right to water by protecting the ecological source that nourishes that right.

South Africa leads the way in requiring the right to water and in explaining that this mandate to fulfill the right to water for humans means maintaining and stewarding a “Reserve” for present and future generations of humans and nonhumans. South Africa’s Minister of Water and Environmental Affairs estimates that ecosystem services provide around seven percent of the nation’s GDP each year.<sup>252</sup> And a recent study estimates that nature provides humans with \$125 trillion USD worth of services annually.<sup>253</sup>

It has taken awhile, however, for South Africa to lead the way in translating aspirations into action. The nation has comprehensive data on the perilous state of its ecological health. According to the South African Biodiversity Institute (SANBI), fifty-seven percent of river ecosystems and sixty-five percent of

---

251. Francis, *supra* note 14, at 153.

252. WWF-SA, *supra* note 81, at 4 (citing E. Molewa, Minister of Water & Environmental Affairs at the 7<sup>th</sup> Pan-African Access and Benefit Sharing Workshop in Phalaborwa, Limpopo, South Africa, February 2013).

253. See Robert Costanza et al., *Changes in the Global Value of Ecosystem Services*, 26 GLOBAL ENVTL. CHANGE 152 (2014).

wetland ecosystems are ecologically threatened, while eighty-four percent of large rivers are endangered or vulnerable.<sup>254</sup> By the government's own assessment, its "water resources are facing ever increasing pressures from climate change, population growth, over utilization of the water resources, poor land-use practices and subsequent pollution."<sup>255</sup> Acid mine drainage has caused terrible pollution in many, if not most, of the nation's waterways.<sup>256</sup>

Given this history of the dangerous state of its ecological sustainability, water providers should not be constrained by a narrow view of what "available resources" entail and how they can be maximized. Fulfilling the human right to water requires sustaining the ecological matrix that is the source of that water, and thus maximizing "available resources." It means investing in ecological infrastructure by protecting the sources of water and prioritizing development away from fragile riparian zones.

However, investment in ecological infrastructure can be highly cost-effective if we account for the value of improving or maintaining those ecosystem services, including water quality and quantity.<sup>257</sup> In 2014, over \$9 billion USD was invested worldwide in ecological infrastructure to protect clean water, providing water to over seven million households and protecting an area of land larger than India.<sup>258</sup> U.S. studies suggest that every dollar spent protecting ecological infrastructure saves between \$7.50 and \$200 in water treatment costs—and that does not even include the costs of repairing or dredging dams, or importing water from elsewhere.<sup>259</sup> One study of a wetland rehabilitated by South Africa's Working for Water program found that communities neighboring the program's sites earned more than double returns on economic investment.<sup>260</sup>

But we take these free ecosystem services for granted—until the ecosystem no longer provides them for free.<sup>261</sup> Well-maintained watersheds and wetlands improve water quality and quantity by acting as natural filters to purify water,

254. SOUTH AFRICAN NATIONAL BIODIVERSITY INSTITUTE (SANBI), NATIONAL BIODIVERSITY ASSESSMENT (2011); see also A. Driver, et al., *National Spatial Biodiversity Assessment 2005: Priorities for Biodiversity Conservation in South Africa*, SANBI BIODIVERSITY SERIES 6 (2005).

255. DEP'T. OF WATER AFFAIRS, NATIONAL WATER RESOURCE STRATEGY, *supra* note 20, at 37.

256. See, e.g., Loretta Feris, *The Public Trust Doctrine and Liability for Historic Water Pollution in South Africa*, 8/1 L. ENV'T & DEV. J. 1, 3–4 (2012); L. Feris & L.J. Kotze, *The Regulation of Acid Mine Drainage in South Africa: Law and Governance Perspectives*, 17 POTCHEFSTROOM ELECTRONIC L. J. 2105 (2014).

257. See SANBI, *supra* note 113, at 2.

258. See, e.g., Genevieve Bennett & Nathaniel Carroll, *Gaining Depth: State of Watershed Investment 2014: Executive Summary*, FOREST TRENDS (Dec. 2014), [http://www.forest-trends.org/dir/sowi\\_2014/](http://www.forest-trends.org/dir/sowi_2014/).

259. SIP 19, *supra* note 13, at 33.

260. B.W. van Wilgen & W.J. De Lange, *The Costs and Benefits of Biological Control of Invasive Alien Plants in South Africa*, AFRICAN ENTOMOLOGY (2010).

261. SIP 19, *supra* note 13, at 14.

regulating flows in both wet seasons (including flood buffering) and dry seasons, preventing erosion and thus reducing sediment load, and enhancing biodiversity both in streams and through careful protection of buffers, in adjacent lands.<sup>262</sup> This sometimes goes under the name of “restoring natural capital,” or essentially “any activity that integrates investment in and replenishment of natural capital stocks to improve the flows of ecosystem goods and services, while enhancing all aspects of human wellbeing.”<sup>263</sup>

Additionally, while traditional “built” infrastructure loses its function and value over time, ecological infrastructure accrues value over the long run as restored areas mature.<sup>264</sup> Perhaps managers in South Africa and elsewhere are learning the hard way that technological infrastructure fixes are only a part of the solution for providing basic water to a growing population, and that technological solutions without ecological solutions will fail. In response, South Africa is now returning to the natural basis for all water provision—as its laws requires—and is proceeding accordingly.

For example, the Department of Environmental Affairs’ “Working for Water” program employs people to clear invasive weeds from more than six million acres in and around the nation’s waterways.<sup>265</sup> Its managers recognize that these plants “pose a direct threat not only to South Africa’s biological diversity, but also to water security, the ecological functioning of natural systems and the productive use of land.”<sup>266</sup> Invasive plants suck up more water than what native South African plants would do in the same environment; these invasive plants consume about seven percent of total annual runoff and could eventually consume more than half if left unmanaged.<sup>267</sup> Moreover, when invasive plants slow stream velocity, surface evaporation increases—all of which decreases the amount of water available for human and nonhuman uses.<sup>268</sup> Furthermore, they crowd out South Africa’s unique, endemic flora and fauna, reducing native biodiversity.<sup>269</sup> “Working for Water” also creates jobs,

262. *Id.* at 14; UNITED NATIONS ENVIRONMENT PROGRAMME, GREEN INFRASTRUCTURE: GUIDE FOR WATER MANAGEMENT 5, 14–16 (2014); Barton H. Thompson, Jr., *Markets for Nature*, 25 WM. & MARY ENVTL. L. & POL’Y REV. 261, 295 (2000).

263. Carsten NeBhover et al., *The Economics of Ecosystems and Biodiversity for National and International Policy Makers* 5 in RESTORING NATURAL CAPITAL: BUSINESS AND PRACTICE. (J. Aronson et al. eds., 2007) (citing *Restoring natural capital: definitions and rationale*, J. Aronson, et al., 2007); see also *Who We Are*, NATURAL CAPITAL PROJECT, <http://www.naturalcapitalproject.org/what-is-natural-capital/> (last visited July 27, 2016).

264. GREEN INFRASTRUCTURE: GUIDE FOR WATER MANAGEMENT, *supra* note 261, at 66.

265. SIP 19, *supra* note 13, at 55.

266. *Working for Water*, REPUBLIC OF S. AFR. DEP’T OF WATER AFFAIRS, <https://www.dwa.gov.za/wfw/> (last visited July 27, 2016).

267. See SANBI, *supra* note 113, at 5.

268. *Working for Water: A South African Sustainability Case*, UNITED NATIONS ENVIRONMENT PROGRAMME, [http://www.unep.org/training/programmes/Instructor%20Version/Part\\_3/readings/WfW\\_case.pdf](http://www.unep.org/training/programmes/Instructor%20Version/Part_3/readings/WfW_case.pdf) (last visited July 31, 2016).

269. SIP 19, *supra* note 13, at 30.



employing tens of thousands of people—especially for women, youth, and disabled people<sup>270</sup> in a nation where chronic unemployment reinforces poverty and threatens the stability of a fragile democracy. One study suggests that if twenty percent of the \$192 billion USD that developing countries invest in traditional infrastructure were replaced by green infrastructure, it would create more than 100 million additional jobs.<sup>271</sup>

According to the National Water Resources Strategy, maintaining water's ecological infrastructure mitigates floods, regulates and enhances stream flow, purifies water, decreases erosion and sedimentation of water, and recharges groundwater—all of which will become more vital as the population grows and climate change intensifies both heat and extreme rainfall events.<sup>272</sup> These pressures matter to eThekweni Water & Sanitation, Durban's municipal water management agency, which has garnered international recognition as “one of the most progressive water and sanitation utilities in the world.”<sup>273</sup> The Agency's Director has exhausted engineering solutions to fulfill the demand for scarce water resources.<sup>274</sup> In addition to various technological fixes,<sup>275</sup> eThekweni is charting new ground in managing ecological infrastructure to provide water to its customers. For example, its uMngeni River catchment project is “aligning diverse resources towards a common vision of investing in ecological infrastructure.”<sup>276</sup> Faced with increasing demand and decreasing supply, the chief water manager now knows that “[t]here are limits to what we can build, but nature builds things that naturally rehabilitate. We need to give nature a chance to work for us.”<sup>277</sup>

The agency is clearing invasive weeds, restoring wetlands and riparian buffer zones, improving grazing practices to decrease water quality impacts, and improving the monitoring of agricultural and industrial pollution.<sup>278</sup> In so doing, eThekweni is fulfilling its public trust responsibilities by managing an

---

270. GREEN INFRASTRUCTURE: GUIDE FOR WATER MANAGEMENT, *supra* note 261.

271. UNITED NATIONS ENVIRONMENT PROGRAMME, GLOBAL GREEN NEW DEAL: POLICY BRIEF 24 (Mar. 2009).

272. DEP'T OF WATER AFFAIRS, NATIONAL WATER RESOURCE STRATEGY, *supra* note 20, at 37–38.

273. “Most Progressive Water Utility in Africa” Wins 2014 Stockholm Industry Water Award, CNW (May 28, 2014), <http://www.newswire.ca/en/story/1362337/-most-progressive-water-utility-in-africa-wins-2014-stockholm-industry-water-award>.

274. See Katheryn Kasavel, *Umgani Ecological Infrastructure Partnership Launched*, URBANEARTH (Dec. 2, 2013), <http://urbaneearth.co.za/articles/umgeni-ecological-infrastructure-partnership-launched>; *Investment in Ecological Infrastructure for Durban's Water*, GRASSLANDS (Feb. 11, 2013), <http://www.grasslands.org.za/news/entry/-investment-in-ecological-infrastructure-for-durbans-water>.

275. CNW, *supra* note 272.

276. *Investment in Ecological Infrastructure for Durban's Water*, *supra* note 273.

277. *SANBI Launches Ecological Infrastructure Partnership in Durban*, GRASSLANDS (Nov. 28, 2013), <http://www.grasslands.org.za/news/entry/sanbi-launches-ecological-infrastructure-partnership-in-durban>.

278. *Investment in Ecological Infrastructure for Durban's Water*, *supra* note 273.

environmental problem with an environmental response. Furthermore, the South African government has named the headwaters of the uMngeni River (which supplies most of the water supply to Durban, an area that generates more than ten percent of South Africa's GDP, as well as the surrounding regions) as a Ramsar Convention Wetlands of International Importance.<sup>279</sup> According to the World Wide Fund for Nature (WWF), giving Ramsar-designated protection "is not only critical for our natural biodiversity heritage . . . but also as a crucial water source for the people of KwaZulu-Natal and for the province's economy."<sup>280</sup>

## VI.

### "THE INDIVISIBILITY OF WATER": SOUTH AFRICA BACK ON THE DEEPLY EQUITABLE PATH

Two recent documents show that eThekweni's work is not an isolated pilot project, but rather points to South Africa's resurgence as an international leader in progressive implementation of the human right to water. South Africa's 2013 revised National Water Resources Strategy (NWRS2)<sup>281</sup> and the 2014 Strategic Integrated Project (SIP) 19: Infrastructure for Water Security,<sup>282</sup> offer expansive visions of how water managers must fulfill their public trust responsibilities to steward the Reserve for present and future generations.

The 2013 NWRS2—a legally binding document that implements the National Water Act<sup>283</sup>—visualizes that the way to equitable water provision is through sustainability, and the way to sustainability is through equitable water provision rooted in enlightened management of the ecological resource.

One could hardly get a clearer expression of marrying equity to ecology than the following description:

Water is a precious resource in South Africa and is fundamental to our quality of life. An adequate water supply of suitable quantity and quality makes a major contribution to economic and social development. To achieve this, healthy water ecosystems are imperative to sustain the water resource, which, in turn, provide the goods and services on which communities depend. This indivisibility of water is a cornerstone of the National Water Policy, to the extent that water ecosystems are not seen as users of water in competition with other users, but as the base from which the resource is derived, without which, growth and development cannot be sustainable.<sup>284</sup>

The NWRS2 takes a holistic view that epitomizes the ideal principles of a deeply equitable approach to water management: "[t]he perspective of equity in

---

279. *Source of the uMngeni River declared South Africa's 21st wetland of international importance*, WWF-SA (Apr. 18, 2013), <http://www.wwf.org.za/?7880/uMngeni-River-Ramsar-Site/>.

280. *Id.*

281. DEP'T OF WATER AFFAIRS, NATIONAL WATER RESOURCE STRATEGY, *supra* note 20.

282. SIP 19, *supra* note 13.

283. DEP'T OF WATER AFFAIRS, NATIONAL WATER RESOURCE STRATEGY, *supra* note 20, at 1.

284. *Id.* at 37.

the Strategy is three dimensional and includes equity in access to water services, equity in access to water resources and equity in access to the benefits from water resource use through economic, social and environmental development and management.”<sup>285</sup>

This focus on equity has been lacking in recent years. As the NWRS2 notes, “since the promulgation and implementation of the NWA, one principle that has not received the desired attention is equity, resulting in the perpetuation of inequitable water allocation.”<sup>286</sup> In particular, the NWRS2 notes shortcomings in reallocating water to those to whom it has been historically denied.<sup>287</sup> To remedy these deficiencies, the Strategy focuses on “the redress of race and gender water allocations for productive economic uses,”<sup>288</sup> including priority water allocations for Black and women users.<sup>289</sup> Such programs are to be implemented with the knowledge that “participation of the poor is critical in eliminating poverty and ensuring the political legitimacy of policies and strategies.”<sup>290</sup> This marries South Africa’s constitutionally prescribed rights to democratic participation<sup>291</sup> with the emerging international customary norms of Environmental Democracy, along with the pragmatics that equity can only be accomplished with the wisdom and legitimate buy-in from the most severely affected parties.<sup>292</sup> While not exactly a bottom-up democratic movement to re-appropriate the commons, as visualized by some scholars and realized in some places, it is nonetheless a step in the right direction towards implementing environmental human rights in a democratic and pragmatic manner.<sup>293</sup> Observing the Public Trust means, in part, reallocating water to citizens to whom the resource has been unfairly denied and prioritizing their participation in managing and defending the trust resource.

The first priority of the NWRS2 proclaims: “[i]n line with the Constitution and the National Water Act, the highest allocation priority is afforded to water for purposes of the Reserve.”<sup>294</sup> The rationale marries human rights to the ecological basis needed to respect, protect, and fulfill those rights:

The first objective is to ensure that sufficient quantities of raw water are available to provide for the basic water needs of people. In terms of current policy, a

---

285. *Id.* at iii.

286. *Id.* at 45.

287. *Id.*

288. *Id.*

289. *Id.*

290. *Id.* at 47.

291. *See* S. AFR. CONST., 1996, § 38 (for broad standing rights including § 38(d) specifying “anyone acting in the public interest.”).

292. Takacs, *supra* note 128, at 71.

293. For an example, see Ugo Mattei, *Institutionalizing the Commons: An Italian Primer*, COMMONSBLOG <https://commonsblog.files.wordpress.com/2007/10/mattei-italian-commons-chapter-short.pdf> (last visited July 31, 2016).

294. DEP’T OF WATER AFFAIRS, NATIONAL WATER RESOURCE STRATEGY, *supra* note 20, at 47.

quantity of 25 litres per person per day has been incorporated into the Reserve determination. Even though this is the minimum volume, this will be progressively increased where appropriate. The second objective is ensuring sufficient water of an appropriate quality to sustain healthy ecosystems.<sup>295</sup>

The NWRS2 notes that while “water is allocated to the environment as a priority and for free by way of the environmental Reserve . . . [t]he environment cannot pay for the water it uses.”<sup>296</sup> The Strategy proclaims that “[t]he pricing of water . . . needs to better reflect its value.”<sup>297</sup> Thus for “ecological sustainability” the NWRS2 recommends:

[t]he water needs for the effective functioning of aquatic ecosystems must be protected. The management activities required to ensure the provision of sufficient water for the ecological reserve must be paid for by all registered and billable users. To promote the preservation of resource quality, the polluter pays principle is adopted.<sup>298</sup>

The philosophy espoused in the NWRS2 makes the “full” in full cost recovery much fuller. The Strategy does not explain what it means by the “polluter pays principle.” But as adapted from international law, it would mean that anyone despoiling the Reserve must pay for its maintenance and recovery. This principle is not merely an expression of the neoliberal paternalistic ethic that if we do not pay for water we will waste it, and thus governments should not give it away for free. Instead, it is a deeply equitable approach to “full” cost recovery. It recognizes that those who can afford to pay must pay for the basic needs of the poor, whose individual and community health will improve with improved water provision. And, those who can afford to pay must pay for those entities that cannot, entities whose provision of ecosystem services we normally regard as free of cost. As a result, ecosystem health (and thus, in turn, human community health) will improve.

The 1998 National Water Act prescribes the protection of the water resources through resource-directed measures and the classification of water resources.<sup>299</sup> Fifteen years later, the NWRS2 frankly admits that “[n]otwithstanding this legislative requirement, there has been a demonstrable drop in aquatic ecosystem health across the country and increased stress on water resources, leaving little buffering capacity for any coming changes and increasing water demand.”<sup>300</sup> The NWRS2 notes that while the country has identified and mapped National Freshwater Ecosystem Priority Areas,<sup>301</sup> it has not sufficiently protected those areas by curtailing or improving the practices of activities that are known to harm them, such as mining, or determined which of

---

295. *Id.*

296. *Id.* at 86.

297. *Id.* at 44.

298. *Id.* at 88.

299. See National Water Act 36 of 1998 (S. Afr.).

300. DEP’T OF WATER AFFAIRS, NATIONAL WATER RESOURCE STRATEGY, *supra* note 20, at 37.

301. *Id.*

those specific areas constitutes the legally mandated Reserve.<sup>302</sup> The crux of this philosophy is that these areas, which comprise eight percent of the land surface and contribute fifty percent of the water supply, “form the foundational ecological infrastructure on which a great deal of built infrastructure for water services depends. They are thus strategic national assets that are vital for water security and need to be acknowledged as such at the highest level across all sectors.”<sup>303</sup>

The NWRS2 stresses that the national stewards should protect riparian buffer zones and all critical areas where groundwater is recharged:

Buffers and healthy riparian zones around rivers and wetlands are known to stabilise banks, trap sediments and filter out pollutants, thereby sustaining water quality and protecting aquatic habitats and associated biota. Rehabilitating and maintaining intact buffers and groundwater recharge areas is a high-priority intervention for improving water security . . . [and] it is prudent to implement a statutory minimum setback line to mitigate impacts on, and ensure the persistence of critical water-related ecological infrastructure.”<sup>304</sup>

The Plan calls for further restoration of these strategic areas, building on prior successful interventions, including the “Working for Water” program.<sup>305</sup> To preserve and restore these crucial areas would mean fulfilling the Public Trust Doctrine’s legal mandate to manage the Reserve for the constitutionally protected human right to water.

#### A. *Strategic Integrated Project 19: Ecological Infrastructure for Water Security*

Government agencies have prepared and approved an eighteen-part Strategic Integrated Plan (SIP) “that intends to transform our economic landscape while simultaneously creating significant numbers of new jobs, and to strengthen the delivery of basic services.”<sup>306</sup> An additional plan was recently submitted: “Ecological Infrastructure for Water Security,” or SIP 19.<sup>307</sup> Coordinated to fulfill the priorities of the NWRS2 (discussed above),<sup>308</sup> SIP 19 is “aimed at improving South Africa’s water resources and other environmental goods and services through the conservation, protection, restoration, rehabilitation and/or maintenance of key ecological infrastructure.”<sup>309</sup> Presenting three hundred and sixty specific activities costing over \$165 million

---

302. *Id.* at 9.

303. *Id.* at 42.

304. *Id.* at 38.

305. *Id.* at 44.

306. PRESIDENTIAL INFRASTRUCTURE COORDINATING COMMISSION, A SUMMARY OF THE SOUTH AFRICAN NATIONAL INFRASTRUCTURE PLAN 6 (2012).

307. SIP 19, *supra* note 13; *see also* DEP’T OF WATER AFFAIRS, NATIONAL WATER RESOURCE STRATEGY, *supra* note 20.

308. SIP 19, *supra* note 13, at 12.

309. *Id.* at 2.

USD,<sup>310</sup> SIP 19 complements SIP 18's focus on improving water provision through improved traditional brick and mortar infrastructure.<sup>311</sup> But according to SIP 19, "the sustained success of SIP 18 is very dependent on the success of SIP 19," as SIP 18's engineering solutions must be coupled with the water that flows from SIP 19's ecological remediation.<sup>312</sup> SIP 19 presents a road map for how the government can fulfill its public trust responsibilities and the basic right to clean water through preserving the ecological matrix from which that water flows.

The holistic purpose of SIP 19 is "to make a significant contribution to the overall goal of ensuring a sustainable supply of fresh, healthy water to equitably meet South Africa's social, economic and environmental water needs for current and future generations through the integrated implementation of projects within identified priority water catchments."<sup>313</sup> The one hundred-page document comprises a model blueprint for how to think about the inextricability of human rights fulfillment, ecological health, and intra- and inter-generational equity. The authors situate ecological infrastructure as "the networks of natural lands, working landscapes and other open spaces that are the substructure or underlying foundation on which the continuance or growth of ecosystem goods and services depends."<sup>314</sup> As SIP 19 expresses, "these benefits are collectively known as 'watershed services,' and society can't do without them."<sup>315</sup> The projects the plan lays out, if implemented, would alleviate poverty through the creation of thousands of jobs (particularly in underserved rural areas), improved farming and fishing output, and the provision of more and cleaner water at lower costs.<sup>316</sup>

SIP 19 states:

It is also becoming increasingly recognised that water crises are not only about water, but are interconnected with other social, political, economic and environmental factors. More integrated and sophisticated approaches are therefore required than simply concentrating on supply-side solutions, as has frequently been the case historically in water sectors across the world, including in South Africa.<sup>317</sup>

The plan offers detailed projects and rationales for improving stream, river, estuary, and wetland ecological infrastructure, reforming agricultural practices near critical water sources,<sup>318</sup> thereby conserving what is irreplaceable and

---

310. *Id.* at 8.

311. DEP'T OF WATER AFFAIRS, STRATEGIC INFRASTRUCTURE PROJECT 18 (SIP 18): NATIONAL WATER AND SANITATION INFRASTRUCTURE MASTER PLAN (2013).

312. DEP'T OF WATER AFFAIRS, STRATEGIC PLAN, *supra* note 10, at 81; *see also* SIP 19, *supra* note 13.

313. *Id.* at 7.

314. *Id.*

315. *Id.* at 13.

316. *Id.* at 71, 75.

317. *Id.* at 12.

318. *See* WWF-SA, *supra* note 81.

restoring derelict lands that would then offer stronger protection for crucial water flows.<sup>319</sup>

When a government views water provision as a problem of ecological infrastructure, it might look to curb soil erosion by improving farming practices (e.g., decreasing ploughing, which, if done in excess, breaks down organic matter in the soil<sup>320</sup>), preventing livestock from grazing in fragile riparian zones, maintaining buffer zones around waterways, and keeping roads and footpaths from the borders of riparian zones.<sup>321</sup> Failing to steward waterways leads not only to poorer conditions for aquatic organisms, but also to poor farming practices. Additionally, streamside erosion leads to the siltation of South Africa's more than four thousand dams, dramatically decreasing the lifespan of these dams and leaving them exposed to the possibility of rupture.<sup>322</sup> Erosion increases the need for and costs of artificial filtration of water and decreases the duration of parts, such as pumps and turbines.<sup>323</sup> Managing these problems at the source not only saves money in the long run by obviating the need for technological fixes, but also helps farmers increase yields, employs people in rural economies, and has ancillary benefits for nonhuman species, which are themselves part of the ecological infrastructure that supports human life. They, in turn, depend upon sound human management to survive.

When we talk about "progressive realization" of a right to water "within its available resources," we must look at what resources the government has at its disposal. Available resources are not fixed, immutable amounts. When a government does not protect the ecological infrastructure of water, it decreases its own resources. It shrinks its own ecological, and thus economic, budget. When a government squanders its ecological resources, it fails to respect the right to water, and it takes away from users what water they could have, thus squandering the public trust. When it permits actors to despoil the resource—through arrogating and wasting water, approving inappropriate pricing schemes, failing to adequately regulate pollution, and promoting unsound development in the most important catchment areas—it fails to protect the right to water. When it neglects to take proactive measures to enhance ecological infrastructure, it fails to fulfill the right to water. When South Africa neglects water's ecological sources, it violates the National Water Act by failing to protect the Reserve, violates its own Constitution by failing to use its resources to fulfill the human right to water, and breaches international legal stipulations for progressive realization of the human right to water. It thus violates its public trust

---

319. DEP'T OF WATER AFFAIRS, STRATEGIC PLAN, *supra* note 10, at 8; *see also* SIP 19, *supra* note 13.

320. WWF-SA, *supra* note 81, at 13.

321. DEP'T OF WATER AFFAIRS, STRATEGIC PLAN, *supra* note 10, at 29, 31; *see also* SIP 19, *supra* note 13.

322. *See, e.g.*, DEP'T OF WATER AFFAIRS, STRATEGIC PLAN, *supra* note 10, at 27, 30, 37, 66; WWF-SA, *supra* note 81, at 20.

323. SIP 19, *supra* note 13, at 27, 30.

responsibilities by failing to steward the natural resources that support human life.

If implemented faithfully, the plans described above, which commit South Africa to fulfill its public trust responsibilities by honoring the “indivisibility of water,” would make the nation an international leader in executing its public trust responsibilities to implement the human right to water in a deeply equitable way.

### CONCLUSION

In South Africa, the vision of the public trust that marries equity to ecology in a holistic way can only be seen if it is implemented as legally required. The South African government has an unfortunate recent history of lack of capacity, diminished coordination among Ministries, and a tendency to approve mining and other ecologically harmful developments at all costs in the name of economic development.<sup>324</sup>

Equity, deep and otherwise, only happens if trustees find and conserve more water through sound management, which entails conserving the Reserve for present and future generations. To not protect the Reserve violates public trust responsibilities. Additionally, the National Water Act’s commands about the Reserve disregards the rights to water named in international norms and in § 27(a)(2) of the Constitution, and fails to progressively fulfill the right to water “within its available resources.”<sup>325</sup> South Africa cannot dissociate equity from ecology—both because the nation’s legal structure demands it not do so and also because it would be impossible to do so even if the law were silent on the subject.

The Public Trust Doctrine prescribes what governments must do to protect the human right to water that citizens are due. The world awaits a vision that links ecology to equity, which sees the preservation of the natural world as the only salvation for those communities. South Africa is not the ethical conscience of the world, but it does have a legal structure that requires it to fulfill the right to water in a sustainable, equitable, and ecologically sensible way. To do so would cement a legacy for the nation’s leaders, civil servants, and citizens. If South Africa promulgated the law, policy, and vision it has described, it would provide the world with hope for a deeply equitable world through marrying ecology to equity. This would, in turn, demonstrate dignity and sustenance

---

324. For example, as documented in CENTER FOR APPLIED LEGAL STUDIES, *THE MAPUNGUBWE STORY: A CAMPAIGN FOR CHANGE* (2015), a recent fight over the operation of the Vele Colliery mine adjacent to Mapungubwe National Park (a national and transboundary park, and UNESCO World Heritage Site) revealed mismanagement of natural heritage, misalignment of key environmentally and socially protective legislation, lack of personnel capacity, failure to observe environmental and other laws by both the government and mining company, all redounding to the negative reputation of the former, and economic disaster to the latter.

325. S. AFR. CONST., (1996), § 27(2).



through a broader conception of humankind's place in the ecological matrix that simultaneously sustains us and now depends on us.

# Trade Law's Responses to the Rise of China

Wentong Zheng\*

## ABSTRACT

This Article offers a systematic examination of trade law's responses to the emergence of China as a major player in world trade. As an intricate set of rules written largely prior to the advent of the China era, trade law had to readjust to the powerful newcomer in ways that eventually changed trade law itself. This Article investigates these changes in four major areas of trade law: antidumping, countervailing duties, safeguards, and managed trade. In almost all of those areas, trade law witnessed a protectionist shift against Chinese products at the expense of sound, consistent principles. But, at the same time, trade law has corrected some of the most egregious protectionist policies on China. These adaptations on the part of trade law tell a story of how an organic legal system evolves in response to changing external circumstances. This Article concludes that at least as an initial assessment, trade law has been rather successful in accommodating China in the new world trade order and has preserved the structural stability of the world trade system without deviating too far from its core principles.

## TABLE OF CONTENTS

INTRODUCTION .....	110
I. TRADE LAW AS A BALANCE .....	112
A. <i>Free Trade Principles</i> .....	112
B. <i>Protectionism</i> .....	114
II. BALANCE DISRUPTED: TRADE LAW'S RESPONSES TO CHINA .....	115
A. <i>Antidumping</i> .....	115
1. <i>Surrogate Values</i> .....	117
2. <i>Country-Wide Rates</i> .....	125

---

DOI: <http://dx.doi.org/10.15779/Z38CS1Z>

\* Associate Professor of Law, University of Florida Levin College of Law. I thank Diane Amann, Julian Arato, Kent Barnett, Pamela Bookman, Sungjoon Cho, Jonathan Cohen, Harlan Cohen, Sarah Dadush, Paolo Farah, Farshad Ghodoosi, Fazal Khan, Joseph Miller, Kish Parella, Sharon Rush, Gregory Shaffer, Daniel Sokol, Christian Turner, Michael Wolf, and David Zaring for stimulating discussions and valuable comments on earlier drafts.

B. Countervailing Duty Law .....	131
1. To Countervail or to Not Countervail? .....	131
2. Double Counting .....	134
3. Public Body .....	139
4. Out-of-Country Benchmarks .....	143
C. Safeguards .....	147
D. Managed Trade .....	150
III. TRADE LAW'S REBALANCING: SUCCESS OR FAILURE? .....	154
CONCLUSION .....	158

## INTRODUCTION

One of the “great dramas” of the twenty-first century is the ascent of China on the world stage.<sup>1</sup> In the span of less than four decades, China’s per capita gross domestic product leapt almost forty-fold from less than two hundred U.S. dollars in 1981 to over seventy-five hundred U.S. dollars in 2014.<sup>2</sup> In 2010, China surpassed Japan to become the world’s second-largest economy after the United States.<sup>3</sup> Measured in purchasing power parity, China’s economy has already overtaken that of the United States as the world’s largest.<sup>4</sup>

One key reason for China’s miraculous economic growth is its participation in international trade. In 1978, China accounted for less than one percent of world trade.<sup>5</sup> That percentage jumped to over ten percent in 2013, twelve years after China’s accession to the World Trade Organization.<sup>6</sup> Today, China is one of the most important players in world trade, ranking as the world’s largest exporting country and second largest importing country of merchandise.<sup>7</sup>

---

1. See G. John Ikenberry, *The Rise of China and the Future of the West: Can the Liberal System Survive?*, FOREIGN AFF., Jan./Feb. 2008, <https://www.foreignaffairs.com/articles/asia/2008-01-01/rise-china-and-future-west>.

2. See GDP PER CAPITA (current US\$), WORLD BANK (2016), <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD>.

3. Andrew Monahan, *China Overtakes Japan as World’s No. 2 Economy*, WALL ST. J., Feb. 14, 2011, <http://www.wsj.com/articles/SB10001424052748703361904576142832741439402>.

4. Keith Fray, *China’s Leap Forward: Overtaking the U.S. as the World’s Biggest Economy*, FIN. TIMES, Oct. 8, 2014, <http://blogs.ft.com/ftdata/2014/10/08/chinas-leap-forward-overtaking-the-us-as-worlds-biggest-economy/>. Purchasing Power Parity measures a country’s economy taking into account varying price levels between countries, particularly in goods and services that are not open to international competition. *Id.*

5. Markus Taube, *Economic Relations Between the PRC and the States of Europe*, in CHINA AND EUROPE SINCE 1978: A EUROPEAN PERSPECTIVE 78, 80 (Richard L. Edmonds ed. 2002).

6. See Trade Profile: China, WORLD TRADE ORG., <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Country=CN&> (last visited July 31, 2016).

7. See *id.*

The rise of China represents a seismic shift in the world trade order. While creating enormous economic opportunities within its borders, China's participation in world trade caused massive job losses in countries that import Chinese products.<sup>8</sup> In response, China's trading partners took numerous trade actions against Chinese products, within and without the parameters of global trade law.<sup>9</sup>

This Article documents how trade law responded to the rise of China in world trade. As an intricate set of rules written largely prior to the advent of the China era, trade law had to readjust to the powerful newcomer in ways that eventually changed trade law itself. This Article investigates these changes in four major areas of trade law: antidumping, countervailing duties, safeguards, and managed trade.<sup>10</sup> In almost all of those areas, trade law witnessed a protectionist shift against Chinese products at the expense of sound, consistent principles. But at the same time, trade law has corrected some of the most egregious protectionist policies on China. These nuanced responses showcase trade law's struggle to regain its footing in the face of unprecedented challenges posed by China's emergence as a major economic power.

Trade law's responses to China offer a case study of the compromises inherent in "embedded liberalism," a trade system where the objective of free trade is balanced against the objective of allowing national governments sufficient space for protectionist policies.<sup>11</sup> This Article tells a story of how China disrupted this balance, and how trade law attempted to rebalance itself by finetuning the major trade policy instruments as they were applied to China. The Article concludes that at least as an initial assessment, trade law has been rather successful in preserving the systemic stability of the world trade system without compromising too much on its core principles.

This Article proceeds as follows. Part I lays out the two competing considerations of trade law: free trade principles and protectionism. Part II discusses how trade law's balance between these two competing considerations was altered in response to the external shocks China caused to the world trade system. In so doing, it centers its discussions on WTO law and policies practiced by the United States and the European Union in four major trade law areas: antidumping, countervailing duties, safeguards, and managed trade. Finally, Part

---

8. According to an estimate by a Washington-based think tank, trade with China caused the loss of 3.2 million jobs in the United States between 2001 and 2013. See Robert E. Scott & Will Kimball, *China Trade, Outsourcing and Jobs*, ECON. POL'Y INST. BRIEFING PAPER #385, Dec. 11, 2014, at 2, <http://s2.epi.org/files/2014/bp385-china-trade-deficit.pdf>.

9. See Wenhua Ji & Cui Huang, *China's Experience in Dealing With WTO Dispute Settlement: A Chinese Perspective*, 45 J. WORLD TRADE 1, 2 (2011) ("Chinese Products are frequently subjected to trade remedy measures and non-tariff barriers in overseas markets . . .").

10. See *infra* Part II.

11. For discussions of embedded liberalism, see ANDREW LANG, *WORLD TRADE LAW AFTER NEOLIBERALISM: REIMAGINING THE GLOBAL ECONOMIC ORDER* (2011); John G. Ruggie, *International Regimes, Transactions, and Change: Embedded Liberalism and the Post-war Economic Order*, 36 INT'L ORGANIZATION 379 (1982).

III offers thoughts on the prospect of trade law's rebalancing with respect to China and whether that rebalancing has been successful thus far.

# I.

## TRADE LAW AS A BALANCE

This Article starts with a basic proposition that trade law embodies a delicate balance between two competing considerations: free trade principles and protectionism. On one hand, trade law strives to adhere to a set of free trade principles aimed at reducing trade barriers and discriminatory practices. On the other hand, as a matter of practical necessity, trade law condones certain protectionist policies that deviate from its core principles for purposes of maintaining the structural stability of the world trade system. These two competing considerations of trade law have to be viewed together to gain a full appreciation of the nature and practice of trade law. As shall become clear, they also form the basic analytical framework for examining trade law's responses to China's rise in world trade.

### A. *Free Trade Principles*

One overarching goal of trade law is to move from a "power-oriented" to a "rule-oriented" regime.<sup>12</sup> Under the auspices of the General Agreements on Tariffs and Trade (GATT) and subsequently the WTO, trade law has come a long way in accomplishing this goal.<sup>13</sup> Scholars concededly disagree as to the extent to which trade law could be characterized as "law" as a court would apply it.<sup>14</sup> However, there is a broad consensus that having a rule-based trade law

---

12. See JOHN H. JACKSON, *THE JURISPRUDENCE OF GATT AND THE WTO: INSIGHTS ON TREATY LAW AND ECONOMIC RELATIONS* 8-10 (2000) (discussing the value of a rule-oriented approach as opposed to a power-oriented approach in the design of international institutions relating to economic activity).

13. See Rachel Brewster, *Rule-Based Dispute Resolution in International Trade Law*, 92 VA. L. REV. 251, 253-60 (2006) (describing the shift from the power-based dispute resolution system under the GATT to the rule-based system under the WTO); R. E. Hudec, *Free Trade, Sovereignty, Democracy: The Future of the World Trade Organization*, 1 WORLD TRADE REV. 211, 219-20 (2002) ("The conventional history of GATT/WTO dispute settlement . . . teaches that GATT dispute settlement evolved from a 'diplomatic' instrument into a 'judicial' instrument."); Arie Reich, *From Diplomacy to Law: The Juridicization of International Trade Relations*, 17 NW. J. INT'L L. & BUS. 775, 776 (1997) ("In recent years, however, there is a growing demand by States to regulate their trade relations by using norms and enforcement procedures that are LEGAL in character, create significant limitations on the sovereignty of the States, and, in extreme cases, even exclude the States' power to determine policy in certain socio-economic fields."). But see Joost Pauwelyn, *Rule-Based Trade 2.0? The Rise of Informal Rules and International Standards and How They May Outcompete WTO Treaties*, 17 J. INT'L ECON. L. 739, 740-45 (2014) (arguing that since the turn of the millennium trade law has witnessed a stagnation of formal treaty-making and a rise in informal rules and mechanisms).

14. Some scholars take the view that the GATT, in essence, is a legal system. See, e.g., JAMES FAWCETT, *LAW AND POWER IN INTERNATIONAL RELATIONS* 87 (1982) ("GATT is both in form and practice an illuminating example of law in international relations."); Daniel K. Tarullo, *Logic, Myth and International Economic Order*, 26 HARV. INT'L L.J. 533, 533 (1985) (noting that the

system is desirable because it allows for “creating greater predictability, redressing unfair power imbalances, and preventing escalating international tensions.”<sup>15</sup>

Trade law, however, is not just any set of rules. It is built on certain principles. At the core of trade law is the so-called “liberal economic doctrine,” which recognizes the benefits of free trade to all participating countries.<sup>16</sup> As a result, the primary purpose of the GATT and the WTO is to dismantle trade barriers.<sup>17</sup> This free trade agenda manifests itself in the fundamental principles of the GATT and the WTO, such as the most-favored nation principle, the national treatment principle, and the tariff binding principle.<sup>18</sup>

Trade law's aspiration to be a principles-based system requires it to be systemically coherent, so that its various components reflect the same policy considerations.<sup>19</sup> This systemic coherence is crucial for, among other things, consistent judicial interpretations of inevitably incomplete treaty rules.<sup>20</sup> The desire to maintain systemic coherence in trade law can be seen in the WTO's umbrella agreement—the Marrakesh Agreement Establishing the WTO. The preamble of the Marrakesh Agreement refers to “the basic principles . . . and the objectives underlying this multilateral trading system.”<sup>21</sup> The WTO Appellate

---

international trade system “looks more like a legal system than do the areas of international law traditionally denominated ‘public’ law.” Some other scholars recognize that the law has some role in the conduct of international trade relations, but emphasize the limitations of that role. *See, e.g.,* C.F. Teese, *A View from the Dress Circle in the Theatre of Trade Disputes*, 5 *WORLD ECON.* 43, 51 (1982) (“[T]he GATT has been reduced from a legalistic instrument, designed to secure an open trading system, to a document which in respect of some important rules acts only to exhort governments not to intervene in international trade.”); Phillip R. Trimble, *International Trade and the “Rule of Law”*, 83 *MICH. L. REV.* 1016, 1017 (1985) (noting that one group of scholars believe that “the principal value of the GATT is that it provides a process through which trade problems are negotiated and compromised within a general framework of rules.”). For detailed discussions of the two views, see Miquel Montana I Mora, *A GATT With Teeth: Law Wins Politics in the Resolution of International Trade Disputes*, 31 *COLUM. J. TRANSNAT'L L.* 103, 109-11 (1993).

15. JOHN JACKSON, *THE WORLD TRADING SYSTEM: LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS* 340 (2d ed. 1997). Even Joost Pauwelyn, who emphasizes the role of informal rules and standards in world trade, does not dispute the desirability of a rule-based trade law system. His argument is only that informal rules and standards may better achieve the goals of a rule-based trade law system in terms of predictability, stability, and neutrality. *See* Pauwelyn, *supra* note 13, at 739-40.

16. Reich, *supra* note 13, at 781.

17. *Id.* at 780. *See also* JAN HOOGMARTENS, *EC TRADE LAW FOLLOWING CHINA'S ACCESSION TO THE WTO* 10 (2004).

18. For discussions of the fundamental principles of the GATT and the WTO, see *Principles of the Trading System*, *WORLD TRADE ORG.* (2016), [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/fact2\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm).

19. *See* Ernst-Ulrich Petersmann, *From “Member-Driven Governance” to Constitutionally Limited “Multilevel Trade Governance” in the WTO*, in *THE WTO AT TEN: THE CONTRIBUTION OF THE DISPUTE SETTLEMENT SYSTEM* 86, 104-105 (Giorgio Sacerdoti et al. eds. 2006) (discussing the importance of general principles of law in WTO jurisprudence).

20. *Id.* at 105.

21. Marrakesh Agreement Establishing the World Trade Organization, 1867 U.N.T.S. 154, 33 I.L.M. 1144 (1994), Preamble [hereinafter Marrakesh Agreement].

Body has also endeavored to introduce and consistently apply certain basic principles to the various WTO agreements.<sup>22</sup>

### *B. Protectionism*

Free trade principles, however, are not the only underlying logic of trade law. While free trade may enhance the economic welfare of the world as a whole, it may also result in concentrated costs for certain segments of a society that have outsized incentives to lobby against free trade.<sup>23</sup> This requires trade law to incorporate many policies that are protectionist in nature in order to soften resistance from parties who would stand to lose from trade liberalization.<sup>24</sup>

Protectionist considerations, therefore, become a constant feature of trade law. Instead of unilaterally reducing trade barriers, which is supposedly in the interests of the liberalizing countries even if other countries do not reciprocate, GATT-WTO member countries wield trade barriers as bargaining chips that will be given away only on a reciprocal basis.<sup>25</sup> Specific examples of protectionist policies can be found in the textile and agricultural sectors, where trade law has deviated from rule-based principles to accommodate political needs.<sup>26</sup> Examples of protectionism are so numerous that Raj Bhala goes as far as arguing that there is no such thing as free trade because “a careful read of any trade agreement reveals . . . express carve-outs for certain preferred sectors, intricate and protective rules of origin, lengthy phase-in periods for trade-liberalizing obligations, and lengthy phase-out periods for trade barriers.”<sup>27</sup>

These two opposing considerations—free trade principles and protectionism—create a fundamental tension in trade law. Protectionism stands for the opposite of almost everything that free trade principles promote. Whereas free trade principles liberalize trade, protectionism restricts it; whereas free trade

---

22. See Gabrielle Marceau, *Balance and Coherence by the WTO Appellate Body: Who Could Do Better?*, in *THE WTO AT TEN: THE CONTRIBUTION OF THE DISPUTE SETTLEMENT SYSTEM* 326, 326-33 (Giorgio Sacerdoti et al. eds. 2006).

23. BERNARD M. HOEKMAN & MICHEL M. KOSTECKI, *THE POLITICAL ECONOMY OF THE WORLD TRADING SYSTEM: THE WTO AND BEYOND* 27-28 (2d ed. 2001).

24. One example of such protectionist policies incorporated in trade law is antidumping, which functions as a safety valve to alleviate pressures resulting from trade liberalization. See J. Michael Finger et al., *Antidumping As Safeguard Policy* (World Bank, Policy Research Working Paper No. 2730, 2001) (discussing the weaknesses of antidumping as a safeguard mechanism); Wentong Zheng, *Reforming Trade Remedies*, 34 *MICH. J. INT'L L.* 151, 163-67 (2012).

25. See Rachel Brewster, *Pricing Compliance: When Formal Remedies Displace Reputational Sanctions*, 54 *HARV. INT'L L.J.* 259, 308 n.218 (2013); Sungjoon Cho & Claire R. Kelly, *Are World Trading Rules Passe?* *VA. J. INT'L L.* 623, 632 (2013) (arguing that the basic architecture of the GATT betrays a merchantist nature because tariff reductions under the GATT are based on reciprocal bargains).

26. See Peter M. Gerhart, *Slow Transformation: The WTO as a Distributive Organization*, 17 *AM. U. INT'L L. REV.* 1045, 1059 (2002).

27. Raj Bhala, *Assessing the Modern Era of International Trade*, 21 *FORDHAM INT'L L.J.* 1647, 1657-58 (1998).

principles disrupt existing trade patterns, protectionism preserves them; whereas free trade principles value systemic coherence, protectionism favors ad hoc solutions. As a practical matter, trade law becomes the compromise of these two opposing considerations.<sup>28</sup>

## II.

### BALANCE DISRUPTED: TRADE LAW'S RESPONSES TO CHINA

The conceptualization of trade law as a balance between two opposing considerations—free trade principles and protectionism—lays the basic framework for analyzing trade law's responses to the emergence of China as a disruptive force in world trade. The exponential growth in Chinese exports dealt a major external shock to the world trade system and dislodged trade law from the delicate balance it managed to maintain prior to China's rise. As will be discussed in detail below, in almost all major areas where trade law authorizes protective measures against import surges, including antidumping, countervailing duties, safeguards, and managed trade, trade law tolerated deviations from its own fundamental principles as a way of preserving the structural stability of the world trade system. The discussions to follow document such deviations and tell a story of trade law losing its balance in response to a powerful, disruptive newcomer.

#### A. Antidumping

Arguably the most important trade-remedy instrument authorized by trade law, antidumping provides a mechanism for an importing country to impose special duties on imports from specific countries without violating the importing country's obligations under global trade rules.<sup>29</sup> Article VI of GATT 1947 defines dumping as the introduction of one country's products into the commerce of another country at "less than the normal value" of the products.<sup>30</sup> Article VI allows an importing country to levy an antidumping duty "not greater in amount than the margin of dumping"<sup>31</sup> if dumping "causes or threatens material injury to an established industry" or "materially retards the establishment of a domestic industry" in the importing country.<sup>32</sup> Subsequent to

---

28. Besides the free trade-versus-protectionism compromise, trade law could reflect compromises along other dimensions as well. One compromise that has been the subject of intense scholarly attention is the compromise between trade law and national sovereignty. See, e.g., John H. Jackson, *The Great 1994 Sovereignty Debate: United States Acceptance and Implementation of the Uruguay Round Results*, 36 COLUM. J. TRANSNAT'L L. 157 (1997). This Article focuses on the free-trade-versus-protectionism compromise as it is most relevant for analyzing how trade law responded to the rise of China.

29. For an overview of antidumping, see Zheng, *supra* note 24, at 159-81.

30. General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994), art. VI:1 [hereinafter GATT 1994].

31. *Id.* art. VI:2.

32. *Id.* art. VI:1.



GATT 1947, antidumping was further affirmed as a legitimate trade policy tool in the 1967 and 1979 Antidumping Codes and then, upon the establishment of the WTO in 1995, in the WTO Antidumping Agreement.<sup>33</sup>

The idea of antidumping itself is a compromise between free trade principles and protectionism. The conventional rationale offered for antidumping is that dumping is an unfair trade practice.<sup>34</sup> This “unfair trade” narrative, however, has been extensively critiqued in the academic literature as lacking sound economic bases.<sup>35</sup> Scholars have instead argued that antidumping should be better viewed as a safety valve that allows importing countries to limit the adverse impact of surging imports on domestic industries.<sup>36</sup> Without this safety valve, the logic goes, countries would be reluctant to make a free trade commitment in the first place.<sup>37</sup>

Arguably, therefore, antidumping is by design a protectionist tool aimed at maintaining orderly trade, not free trade. The immediate goal of antidumping is contrary to that of free trade, but in the grand scheme of trade policy, antidumping is a necessary evil that must be tolerated for the sake of facilitating free trade.<sup>38</sup> To accomplish this higher goal, a delicate balance must be struck where antidumping will be allowed to function, yet not to the extent that it jeopardizes the rule-based world trade system.

33. See Agreement on the Implementation of Article VI, June 30, 1967, 19 U.S.T. 4348, T.I.A.S. 6431 [hereinafter 1967 Antidumping Code]; Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade, Apr. 12, 1979, 31 U.S.T. 4919, T.I.A.S. 9650 [hereinafter 1979 Antidumping Code]; Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1868 U.N.T.S. 201 [hereinafter WTO Antidumping Agreement].

34. See *An Introduction to U.S. Trade Remedies*, U.S. INT’L TRADE ADMIN., <http://enforcement.trade.gov/intro/> (last visited July 31, 2016) (characterizing antidumping as a law that protects businesses from unfair competition resulting from unfair pricing by foreign companies).

35. See, e.g., John J. Barceló III, *Antidumping Laws As Barriers to Trade—The United States and the International Antidumping Code*, 57 CORNELL L. REV. 491, 502–13 (1972) (rejecting the arguments that dumping is an “unfair trade practice,” confers an “artificial advantage,” “exploit[s] monopoly power,” and “inflict[s] injurious adjustment costs”); Raj Bhala, *Rethinking Antidumping Law*, 29 GEO. WASH. J. INT’L L. & ECON. 1, 8–21 (1995) (criticizing the economic rationales of antidumping); Reid M. Bolton, *Antidumping and Distrust: Reducing Anti-dumping Duties Under the W.T.O. Through Heightened Scrutiny*, 29 BERKELEY J. INT’L L. 66, 71–74 (2011) (rejecting various economic justifications for antidumping); Sungjoon Cho, *Anticompetitive Trade Remedies: How Antidumping Measures Obstruct Market Competition*, 87 N.C. L. REV. 357, 370–76 (2009) (criticizing the “unfair trade” rationale of antidumping); DOUGLAS A. IRWIN, *FREE TRADE UNDER FIRE* 162 (3d ed. 2009) (arguing that international price discrimination is neither unfair nor a problem unless it harms competition).

36. See, e.g., Finger, *supra* note 24.

37. For discussions of antidumping as a safety valve, see Zheng, *supra* note 29, at 163–67.

38. See Luz Elena Reyes de la Torre & Jorge G. Gonzalez, *Antidumping and Safeguard Measures in the Political Economy of Liberalization: The Mexican Case*, in *SAFEGUARDS AND ANTIDUMPING IN LATIN AMERICAN TRADE LIBERALIZATION: FIGHTING FIRE WITH FIRE* 205, 243 (J. Michael Finger & Julio J. Nogues eds., 2006) (“On many occasions, high-ranking officials stated that the trade defense system was a necessary evil, but that it should be kept under strict control through its professionalization and the development of its methods and regulations.”).

Trade law's balancing act regarding antidumping was already difficult enough before China upended the prevailing world trade order.<sup>39</sup> With the emergence of China as a major participant in world trade, the protectionist element of antidumping has been stretched far and wide to mitigate the impact of China, to a point that threatens the integrity of the rule-based world trade system.<sup>40</sup> As will be detailed below, the rise of China has accentuated tensions between antidumping and global trade rules in two prominent respects: the use of "surrogate values" in calculating antidumping duties and the resort to country-wide antidumping duty rates.

### 1. *Surrogate Values*

Under Article VI of the GATT, antidumping duties are calculated on the basis of a comparison between the price at which the subject merchandise is sold in the importing jurisdiction and the "normal value" of such merchandise.<sup>41</sup> Dumping arises if the price of the product exported from one country to another is less than "the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country."<sup>42</sup> When the home-market price of the product is unavailable, dumping arises if the price of the product is less than "either . . . the highest comparable price for the like product for export to any third country in the ordinary course of trade, or . . . the cost of production of the product in the country of origin plus a reasonable addition for selling cost and profit."<sup>43</sup> Obviously, these provisions envision the use of *actual* prices or costs of the allegedly dumped product in its home market or third-country markets as the gauge of its normal value.

Drafters of the GATT, however, were well aware that actual prices or costs would not provide a proper basis for comparison when such prices or costs were not determined by market forces. In Ad Article VI,<sup>44</sup> the GATT recognizes that "in the case of imports from a country which has a complete or substantially complete monopoly of its trade and where all domestic prices are fixed by the State, special difficulties may exist in determining price comparability" for

---

39. Over the years, the world trade community has struggled to put constraints on the use of antidumping for the sake of procedural fairness and predictability. For example, one issue that has divided the world trade community is the issue of zeroing in antidumping—the practice of artificially inflating dumping margins by treating negative dumping margins for product subgroups as zero. See Chad Bown & Thomas J. Prusa, *U.S. Antidumping: Much Ado about Zeroing* (World Bank Policy Research Working Paper 5352), <http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-5352>.

40. As discussed earlier, the strong consensus in the academic literature is that antidumping lacks integrity at a fundamental level, given that what it purports to remedy is not unfair except in very limited circumstances. See *supra* note 34 and accompanying text.

41. GATT 1994, *supra* note 30, art. VI:1(a).

42. *Id.*

43. *Id.* art. VI:1(b).

44. The "Ad" articles of the GATT are the interpretive notes accompanying the GATT articles. See Carol J. Beyers, *The U.S./Mexico Tuna Embargo Dispute: a Case Study of the GATT and Environmental Progress*, 16 MD. J. INT'L L. 229, 237 n.68 (1992).

purposes of the dumping analysis.<sup>45</sup> In such cases, Ad Article VI authorizes an importing country to “take into account the possibility that a strict comparison with domestic prices in such a country may not always be appropriate.”<sup>46</sup> It does not specify, however, exactly how to take this possibility into account, leaving the door open to policy innovations on the part of GATT contracting parties.

Arguably, the GATT’s recognition of the need for special treatment of imports from state-controlled economies makes logical sense. If antidumping duties measure the underpricing of a product, they should not be based on home-market prices artificially set by a government for “social and political engineering” purposes.<sup>47</sup> Otherwise, one effective way to circumvent antidumping duties would be for a government to use its unlimited financial power to set home-market prices at artificially low levels.<sup>48</sup>

The flexibility allowed under the GATT for imports from nonmarket economies (NMEs) soon found its use in the Cold War era. Beginning in the 1960s, the U.S. Treasury Department, the agency responsible for antidumping investigations in the United States at the time, began experimenting with a special antidumping methodology for imports from the Soviet Union and Eastern European countries.<sup>49</sup> Rejecting the home market prices in those countries as being state-controlled, the U.S. Treasury Department used the home market or export prices of the same or similar products produced in countries where the relevant product markets were not state-controlled, primarily Western European countries, as the basis of comparison with U.S. prices in calculating antidumping duties.<sup>50</sup> This practice was subsequently recognized by section 205(c) of the Trade Act of 1974, which provided that the “foreign market value”—the U.S. term at the time for “normal value”—of a product from a state-

---

45. GATT 1994, *supra* note 30, ad art. VI.

46. *Id.*

47. See Robert A. Anthony, *The American Response to Dumping from Capitalist and Socialist Economies—Substantive Premises, and Restructured Procedures After the 1967 GATT Code*, 54 CORNELL L. REV. 159, 204 (1969) (“Prices in a ‘controlled’ economy are often the instruments of social and political engineering, and may be set at artificial levels for reasons having nothing to do with natural economic relationships as those would be judged in a free-market economy.”).

48. *Id.*

49. See, e.g., Bicycles from Czechoslovakia, 25 Fed. Reg. 6657 (1960); Jalousie-Louvre-Sized Sheet Glass from Czechoslovakia, 27 Fed. Reg. 8457 (1962); Portland Cement from Poland, 28 Fed. Reg. 6660 (1963); Window Glass from U.S.S.R., 29 Fed. Reg. 8381 (1964); Fur Felt Hoods, Bodies, and Caps from Czechoslovakia, 31 Fed. Reg. 15,024 (1966); Cast Iron Soil Pipe and Fittings from Poland, 32 Fed. Reg. 2901, 8250 (1967); Pig Iron from East Germany, 33 Fed. Reg. 5105, 9375 (1968); Titanium Sponge from the U.S.S.R., 33 Fed. Reg. 5467, 5960, 6377 (1968).

50. Anthony, *supra* note 47, at 200-201. For more detailed descriptions of the Treasury Department’s antidumping practices for imports from the former Soviet Union and Eastern European countries in the 1960s, see Alexis C. Coudert, *The Application of the United States Antidumping Act in Light of a Liberal Trade Policy*, 65 COLUM. L. REV. 189, 224-27 (1965); Comment, *U.S. Trade Laws Hinder the Development of U.S.-P.R.C. Trade*, 22 COLUM. J. TRANSNAT’L L. 135, 146-49 (1983) [hereinafter *U.S.-P.R.C. Trade*]; Peter Buck Feller, *The Antidumping Act and the East-West Trade*, 66 MICH. L. REV. 115, 126-33 (1967).

controlled-economy country should be determined on the basis of either the price at which the same or similar merchandise of a non-state-controlled-economy country is sold for domestic consumption or exports to other countries, or the constructed value of the same or similar merchandise in a non-state-controlled-economy country.<sup>51</sup>

The sound logic of this surrogate-value approach, however, coincides with a grave potential for unfair treatment. Producers from NME countries could exert little control over the amount of antidumping duties imposed on their products, given that it is not their own prices or costs, but prices or costs from surrogate countries, that matter in the antidumping process.<sup>52</sup>

This potential for unfair treatment was most vividly on display in 1975 in *Electric Golf Cars from Poland*, in which a Polish golf car manufacturer was found to have dumped its products in the United States, first based on the sales prices of a small Canadian producer<sup>53</sup> and then later, based on the sales prices of a U.S. producer.<sup>54</sup> Using U.S. producers' prices as the basis of normal value effectively barred the import of these products, as imported products would have to be sold at a higher price than the same or similar U.S. products when transportation costs are taken into account.<sup>55</sup>

The nonsensical outcome in *Electric Golf Cars from Poland* prompted the U.S. Treasury Department to rectify the most unreasonable elements of its surrogate-country methodology by promulgating a new antidumping regulation in 1978.<sup>56</sup> The 1978 regulation prioritized the use of prices or constructed values from third countries whose stages of economic development were comparable to that of the exporting state-controlled-economy country.<sup>57</sup> When the foreign market value of the allegedly dumped product had to be constructed from the costs of producing the product, the 1978 regulation required that the *actual* amounts of the factors of production incurred by the specific NME producer in producing the product be used in calculating the constructed value, although such factors of production would still be valued using prices taken from surrogate countries.<sup>58</sup> These provisions reduced the arbitrariness inherent in the

---

51. See Pub. L. No. 93-618, Title III, § 321, 88 Stat. 1978 (repealed, Trade Agreements Act of 1979, Pub. L. 96-39, Title I, § 106, 93 Stat. 144). For more discussions of section 205(c) of the Trade Act of 1974, see Comment, *Dumping by State-Controlled-Economy Countries: The Polish Golf Cart Case and the New Treasury Regulations*, 128 U. PENN. L. REV. 217, 224-27 (1979) [hereinafter *Dumping by SCE Countries*].

52. See *id.* at 224-25.

53. See *Electric Golf Cars from Poland*, 40 Fed. Reg. 25,497, 25497 (1975).

54. See Letter from Carl W. Schwarz, Counsel for Melex USA, Inc., to Representative Charles A. Vanik, Chairman of the Subcomm. on Trade of the House Comm. on Ways and Means (Apr. 27, 1979), reprinted in *Multilateral Trade Negotiations: Hearings Before the Subcomm. on Trade of the House Comm. on Ways and Means*, 96th Cong., 1st Sess. 734, 735 (1979).

55. See *Dumping by SCE Countries*, *supra* note 51, at 229.

56. See 43 Fed. Reg. 35,262, 35265 (Aug. 9, 1978).

57. 19 C.F.R. § 153.7(b) (1979) (setting forth a hierarchy of three alternative methods for measuring the foreign market value of merchandise from state-controlled-economy countries).

58. 19 C.F.R. § 153.7(c). The 1978 regulation used the term "specific objective components

NME methodology and, for the first time, granted NME producers some limited abilities to predict and control their antidumping exposure.

It was against this backdrop that China came on the antidumping scene. In the late 1970s, shortly after China embarked on its ambitious economic reform programs, trade between China and Western countries began to increase rapidly.<sup>59</sup> In 1981, in *Natural Menthol from China*, the first-ever antidumping action filed in the United States against a Chinese product, the U.S. Commerce Department (USDOC) <sup>60</sup> rejected Chinese domestic menthol prices as a benchmark for measuring antidumping duties for Chinese menthol exported to the United States because the Chinese prices were state-controlled.<sup>61</sup> In so doing, the USDOC entertained, but eventually rejected, the Chinese respondents' argument that China's state control in the particular economic sector in question—the agricultural sector—was not to such an extent that would disqualify Chinese menthol prices from being considered in antidumping investigations.<sup>62</sup> The USDOC then went on to use prices of menthol exported from Paraguay to the United States as the basis for calculating antidumping duties for Chinese menthol.<sup>63</sup> Subsequent to the Chinese menthol case, in the 1980s, the USDOC routinely treated China as a state-controlled-economy country and used prices from surrogate countries to calculate antidumping duties for Chinese products.<sup>64</sup>

By then, however, China did not appear to be receiving a higher level of scrutiny from antidumping authorities than other state-controlled-economy countries, to which the same surrogate-country methodology was regularly applied.<sup>65</sup> After all, as of the 1980s, China's potential as a disruptive force in

---

or factors of production" to refer to the actual amounts of the factors of production used in producing the allegedly dumped product. *See id.*

59. The volume of bilateral trade between China and the United States, for example, increased from \$374 million in 1977 to \$5.49 billion in 1981. *See* U.S. DEP'T OF COMMERCE, INT'L TRADE ADMIN., FOREIGN ECONOMIC TRENDS AND THEIR IMPLICATIONS FOR THE UNITED STATES—CHINA, FET 82-112 (1982).

60. In January 1980, President Jimmy Carter transferred the responsibility for conducting antidumping investigations from the Treasury Department to the Commerce Department. *See* William P. Alford, *When is China Paraguay? An Examination of the Application of the Antidumping and Countervailing Duty Laws of the United States to China and Other "Nonmarket Economy" Nations*, 61 S.CAL. L. REV. 79, 88 n.51 (1987).

61. *See Antidumping, Natural Menthol from the People's Republic of China; Final Determination of Sales at Less Than Fair Value*, 46 Fed. Reg. 24614, 24614 (Dep't of Comm. May 1, 1981) [hereinafter *Chinese Menthol Final USDOC Determination*].

62. *See Natural Menthol from the People's Republic of China; Antidumping—Preliminary Determination of Sales at Less Than Fair Value and Suspension of Liquidation*, 46 Fed. Reg. 3258, 3258-60 (Dep't of Comm. Jan. 14, 1981) [hereinafter *Chinese Menthol Preliminary USDOC Determination*].

63. *See Chinese Menthol Final USDOC Determination*, *supra* note 61, at 24,614.

64. The countries that were used as China's surrogate included Thailand, the Dominican Republic, Colombia, Pakistan, Singapore, Hong Kong, India, Indonesia, and Spain. *See* Alford, *supra* note 59, at 89.

65. *Id.*

world trade was not fully visible, obviating any need for aggressive, nonconventional antidumping policy aimed specifically at China.

During the late 1980s, with no NME countries posing an existential threat to the world trade order,<sup>66</sup> the constant tug-of-war between free trade principles and protectionism within trade law continued to tip in the direction of the former in the area of NME methodology. In the United States, the 1988 Omnibus Trade and Competitiveness Act modified the NME methodology used by the USDOC, making the constructed value of the factors of production of the NME product the preferred method of measuring the normal value of the product.<sup>67</sup> Only when the information necessary for calculating the constructed value of the factors of production was unavailable would the USDOC be allowed to measure the normal value of the NME product on the basis of the price at which the same or similar product was sold in a surrogate country.<sup>68</sup>

In implementing the new NME methodology under the 1988 law for Chinese producers, the USDOC initially showed much greater flexibility than the statute required. In 1991, in *Oscillating Fans and Ceiling Fans from the People's Republic of China*, the USDOC adopted a "mix-and-match" approach for NME prices and stated that if it could be established that inputs purchased in an NME were purchased at market-oriented prices, such actual prices might be substituted for surrogate-country values in the factors-of-production analysis.<sup>69</sup> Later in the same year, in *Chrome-Plated Lug Nuts from the People's Republic of China*, the USDOC again confirmed the mix-and-match approach, stating that "for certain inputs into the production process, market forces may be at work."<sup>70</sup> That would be the case, according to the USDOC, if inputs were imported from suppliers in market economy countries, or if market forces were at work "in determining the prices for locally-sourced goods in the nonmarket economy."<sup>71</sup> In these cases, the USDOC believed that "it is appropriate to use those prices in lieu of values of a surrogate, market-economy producer, because they are market-driven prices and they reflect the producer's actual experience."<sup>72</sup> In an implicit admission to the drawbacks of the surrogate-country method, the USDOC further stated that "[t]here is nothing to be gained in terms of accuracy,

---

66. During this time period, the country perceived to be posing the largest threat to the existing world trade order was Japan, which, despite its hierarchical economic structures, was not considered an NME country.

67. See 19 U.S.C. § 1677b(c)(1)(1989).

68. See 19 U.S.C. § 1677b(c)(2).

69. *Oscillating Fans and Ceiling Fans from the People's Republic of China*, 56 Fed. Reg. 25,664, 25,667 (Dep't of Comm. Jun. 5, 1991) (preliminary determinations of sales at less than fair value).

70. *Chrome-Plated Lug Nuts from the People's Republic of China*, 56 Fed. Reg. 46,153, 46,154 (Dep't of Comm. Sept. 10, 1991) (final determination of sales at less than fair value).

71. *Id.*

72. *Id.*

fairness, or predictability in using surrogate values when market-determined values exists in the NME country.”<sup>73</sup>

The USDOC’s push to rationalize the surrogate-value method, however, led to tensions between antidumping and another area of trade law—countervailing duty law. A parallel trade remedy instrument authorized under global trade rules, countervailing duty law allows an importing country to impose special countervailing duties on imported products to offset subsidies conferred by foreign governments on such products.<sup>74</sup> Prior to the 1990s, the USDOC took the position that a subsidy was “any action that distorts or subverts the market process and results in a misallocation of resources.”<sup>75</sup> Because markets were fictitious in NME countries in the first place, subsidies “have no meaning” in such countries.<sup>76</sup> But when the USDOC began recognizing some prices in China as being driven by market forces, United States petitioners wasted no time in reviving the argument that countervailing duty law should begin to apply to Chinese products in market-oriented sectors.<sup>77</sup>

Apparently reluctant to change its long-standing practice of not applying countervailing duty law to imports from NMEs, the USDOC retreated from using actual Chinese prices as the comparison basis in antidumping. In *Sulfanilic Acid from the People’s Republic of China* in 1992, the USDOC announced three criteria for determining whether an NME producer operates within a market-oriented industry in the NME: (1) there must be virtually no government involvement in setting prices or amounts to be produced for the merchandise under investigation; (2) the industry producing the merchandise under investigation should be characterized by private or collective ownership; and (3) market-determined prices must be paid for “all significant inputs, whether material or non-material, and for an all but insignificant proportion of all the inputs accounting for the total value of the merchandise under investigation.”<sup>78</sup> If these conditions were not met, the producer would be treated as an NME producer and surrogate prices or costs from third countries would be used to calculate the normal value of the merchandise under investigation.<sup>79</sup> Once the NME producer failed this market-oriented-industry test, the USDOC would effectively no longer grant requests to evaluate whether individual inputs used

---

73. *Id.*

74. See GATT 1994, *supra* note 30, art. VI:3.

75. Carbon Steel Wire Rod from Poland, 49 Fed. Reg. 19,374, 19375 (Dep’t of Comm. May 7, 1984) (final negative countervailing duty determination).

76. *Id.* (“It is this fundamental distinction—that in an NME system the government does not interfere in the market process, but supplants it—that has led us to conclude that subsidies have no meaning outside the context of a market economy.”).

77. See Oscillating Fans and Ceiling Fans from the People’s Republic of China, 56 Fed. Reg. 57,616 (Dep’t of Comm. Nov. 13, 1991) (initiation of countervailing duty investigations); Chrome Plated Lug Nuts from the People’s Republic of China, 57 Fed. Reg. 877 (Dep’t of Comm. Jan. 9, 1992) (initiation of countervailing duty investigations).

78. Sulfanilic Acid from the People’s Republic of China, 57 Fed. Reg. 9409, 9411 (Dep’t of Comm. Mar. 18, 1992) (preliminary determination of sales at less than fair value).

79. *Id.*

by the producer were sourced from within the NME in accordance with market principles.<sup>80</sup> In so doing, the USDOC ushered in an all-or-nothing approach to replace the mix-and-match approach it used only months before in *Oscillating Fans and Ceiling Fans* and *Chrome Plated Lug Nuts*.

After abandoning the mix-and-match approach, the USDOC moved to terminate the pending countervailing duty proceedings against Chinese producers, on the grounds that the Chinese industries in question were not market-oriented.<sup>81</sup> For the next twenty-five years, antidumping would become the sole remedy against low-priced Chinese imports.<sup>82</sup> In the meantime, the USDOC strictly applied the market-oriented industry test in antidumping proceedings involving Chinese products, resulting in a *de facto* rule under which surrogate values were used for all Chinese producers.

For the time being, the USDOC managed to defuse a crisis in trade law as it applied to China. One could disagree with the USDOC about the soundness of its judgment that Chinese industries were still not market-oriented despite progress in market reforms in China. But, at least the USDOC's policy towards China was internally consistent. If market forces were not strong enough in China to allow Chinese prices to be used as the comparison basis in antidumping, they should not be strong enough to give rise to subsidies, which are a meaningful concept only if there are real markets to deviate from. At the time, the USDOC was able to rely on antidumping as the exclusive remedy for Chinese imports in part because in the early 1990s, the level of import protection offered by antidumping—with the help of the surrogate-value method—was adequate to cope with China's burgeoning, yet still not dominating, export prowess. This would change twenty-five years later, when China's threat to the global trade order and the pressure to counteract it were in full swing.<sup>83</sup> As

---

80. In *Sulfanilic Acid*, the Chinese respondent argued that the prices at which it purchased some of its inputs were not subject to state control and were market driven. *Id.* The USDOC rejected this argument by citing the lack of documentary evidence indicating that market forces were at work for those inputs. *Id.* Subsequently, in its amended final determination in *Chrome Plated Lug Nuts* in response to court remand, the USDOC made clear that once it was shown that one significant input was not purchased at a market-determined price, "there [was] no need to reach a similar determination with respect to any other significant inputs." *Chrome Plated Lug Nuts*, 57 Fed. Reg. 15,052, 15053 (Dep't of Comm. Apr. 24, 1992) (amendment to final determination of sales at less than fair value and amendment to antidumping order).

81. See *Oscillating and Ceiling Fans from the People's Republic of China*, 57 Fed. Reg. 24,018, 24019 (Dep't of Comm. Jun. 5, 1992) (final negative countervailing duty determinations) ("Therefore, we have determined that the PRC fan industry is not an MOI. As a result, we determine that the CVD law cannot be applied to the PRC fan industry."); *Chrome-Plated Lug Nuts and Wheel Locks from the People's Republic of China*, 57 Fed. Reg. 10,459, 10460 (Dep't of Comm. Mar. 26, 1992) (rescission of initiation of countervailing duty investigation and dismissal of petition) ("[W]e determine that the PRC producers of lug nuts are nonmarket economy producers to which the countervailing duty law cannot be applied.").

82. This changed in 2007, when the USDOC applied countervailing duty law to Chinese products, citing changes that occurred in the Chinese economy. See *infra* Part II.B.1 for more discussions.

83. The trade deficit of the United States with China grew to \$258 billion in 2007. See *Trade in Goods with China*, U.S. CENSUS BUREAU (Sept. 04, 2014),



discussed in more detail below, escalating protectionist pressures eventually resulted in a more dramatic response to Chinese exports, a response that entailed the simultaneous imposition of antidumping duties calculated using the NME methodology and countervailing duties on Chinese products at the expense of trade law's internal logic and coherence.<sup>84</sup>

The use of surrogate values in antidumping proceedings involving Chinese products has been sanctioned by global trade rules. Upon the establishment of the WTO in 1994, global trade rules inherited the basic framework laid under the GATT for handling antidumping for NME producers. The WTO Antidumping Agreement, enacted to interpret and implement Article VI of the GATT, contained no explicit references to the use of surrogate values for imports from NME countries.<sup>85</sup> Therefore, Ad Article VI of the GATT 1947, which was now incorporated into the GATT 1994, remained the only explicit provision in the WTO's founding legal documents on the surrogate-value issue. The absence of the surrogate-value issue in the WTO Antidumping Agreement indicates that by 1994, WTO members perhaps did not consider the threats from NME countries to be grave enough to warrant heightened attention to the surrogate-value issue, given that the communist regimes in the former Soviet Union and Eastern Europe collapsed several years earlier and that China's export machines were just beginning to rev up.

This changed when China gained WTO membership in 2001, by which time China's surging exports, along with the prospect of even greater market access afforded by WTO membership, forced existing WTO members to explicitly authorize the use of surrogate values for Chinese products in China's WTO accession documents. Paragraph 15(a) of the China Accession Protocol states that "[i]n determining price comparability under Article VI of the GATT 1994 and the Anti-Dumping Agreement, the importing WTO Member shall use either Chinese prices or costs for the industry under investigation *or a methodology that is not based on a strict comparison with domestic prices or costs in China*."<sup>86</sup> Paragraph 15(a)(ii) further provides that the use of non-Chinese prices or costs would be allowed if "the producers under investigation cannot clearly show that market economy conditions prevail in the industry producing the like product with regard to manufacture, production and sale of that product."<sup>87</sup> Paragraph 15(a)(ii), however, is set to expire fifteen years after the date of China's accession.<sup>88</sup>

---

<http://www.census.gov/foreign-trade/balance/c5700.html>.

84. See *infra* Part II.B.1.

85. See Chad P. Bown & Petros C. Mavroidis, *One (Firm) Is Not Enough: A Legal-Economic Analysis of EC-Fasteners*, 12 *WORLD TRADE REV.* 243, 255 (2013).

86. Accession of the People's Republic of China, Decision of 10 November 2001, WT/L/432 (Nov. 23, 2001), art. 15(a) [hereinafter *China Accession Protocol*].

87. *Id.* art. 15(a)(ii).

88. *Id.* art. 15(d). There are fierce debates on the legal consequences of the expiration of Paragraph 15(a)(ii). See *infra* notes 291-297 and accompanying text.

Like Ad Article VI of the GATT, Paragraph 15(a) of the China Accession Protocol only states that surrogate values could be used for Chinese products, but does not elaborate on how they should be used. The lack of specifics in the GATT and the China Accession Protocol affords WTO member countries wide latitude in the use of surrogate values and therefore preserves flexible policy space for handling antidumping for Chinese imports. In 2011, a WTO Dispute Settlement Panel affirmed this flexible policy space in *EU-Footwear*. In this case China challenged the European Commission's surrogate-country selection procedure and its selection of Brazil as the surrogate country for antidumping investigations involving imports of Chinese footwear.<sup>89</sup> Because there are no WTO rules on the procedure or criteria for the selection of a surrogate country,<sup>90</sup> China could only assert that the European Union's surrogate-country selection procedure violated its general obligations under other WTO provisions. In particular, China claimed that the EU had violated Article 2.4 of the WTO Antidumping Agreement, which requires a "fair comparison" between the export price and the normal value in calculating antidumping duties.<sup>91</sup> The WTO Panel rejected this argument, stating that Article 2.4 of the WTO Antidumping Agreement only concerns the comparison of the export price and the normal value after the component elements of the comparison have already been established.<sup>92</sup>

## 2. Country-Wide Rates

In addition to the use of surrogate values, the protectionist pressures to contain China's exports in the multilateral trading system led to another policy innovation by importing countries: the use of country-wide, instead of company-specific, antidumping duty rates. As discussed below, this policy innovation, when coupled with the use of adverse facts available, results in much higher antidumping rates, effectively serving the protectionist needs of importing countries. However, the policy innovation has a tenuous legal basis in trade law. As discussed below, China successfully challenged the use of country-wide antidumping rates for its products before the WTO as being inconsistent with WTO rules. When asked to choose between preserving the integrity of the rule-

---

89. See Report of the Panel, *European Union-Anti-Dumping Measures on Certain Footwear from China*, WT/DS405/R (Oct. 28, 2011). The European Commission selected Brazil as the surrogate country in the underlying investigations despite the Chinese parties' argument that Thailand, India, or Indonesia would be a more suitable surrogate country than Brazil. See *id.* ¶¶ 7.254-.255.

90. China Accession Protocol, *supra* note 86, ¶ 7.258.

91. *Id.* ¶ 7.261. China argued that this "fair comparison" requirement is an independent obligation that applies to all aspects of the establishment of normal value, including the selection of a surrogate country. *Id.*

92. *Id.* ¶ 7.263 ("[I]t is clear that the requirement to make a fair comparison in Article 2.4 logically presupposes that normal value and export price, the elements to be compared, have already been established."). The WTO Panel also rejected China's other arguments that the EU's surrogate-country selection procedure violated Articles 2.1 and 17.6(1) of the WTO Antidumping Agreement. See *id.* ¶¶ 7.259-.260.

based world trade system and granting sufficient policy leeway to protect the status quo, the WTO opted for the former.

By way of background, Article 6.10 of the WTO Antidumping Agreement requires that “[antidumping] authorities shall, as a rule, determine an individual margin of dumping for each known exporter or producer concerned of the product under investigation.”<sup>93</sup> The authorities may deviate from this requirement if “the number of exporters, producers, importers or types of products involved is so large as to make such a determination impracticable.”<sup>94</sup> In such cases, the authorities are allowed to “limit their examination either to a reasonable number of interested parties or products by using samples . . . , or to the largest percentage of the volume of the exports from the country in question which can reasonably be investigated.”<sup>95</sup>

In the late 1980s—a period that predated the WTO Antidumping Agreement—United States petitioners began making the argument that a country-wide antidumping duty rate should be assigned to Chinese producers or exporters who could not demonstrate an absence of government control over their business operations. In *Certain Headwear from the People’s Republic of China* in 1989, for example, the U.S. petitioner argued that the Chinese government owned all trading companies in China and the establishment of company-specific rates with large variations “facilitates circumvention in a state-controlled economy where exports can be easily directed and diverted among the trading companies by the State.”<sup>96</sup> The USDOC rejected this argument, stating that “[t]he former branches of the national trading companies have separated from the national companies and we found no evidence that the prices the branches charge for exports to the United States are set by or coordinated through the national trading companies.”<sup>97</sup> The USDOC also noted that in past antidumping investigations, it always calculated separate rates for different Chinese national trading companies even though it treated China as a state-controlled economy.<sup>98</sup>

In 1991, however, the USDOC made an about-face on the separate-rate issue and denied, for the first time, a request for separate rates by Chinese exporters. In *Heavy Forged Hand Tools from the People’s Republic of China*, the USDOC assigned one country-wide antidumping rate to three Chinese exporters that were former branches of a Chinese national trading company.<sup>99</sup>

---

93. WTO Antidumping Agreement, *supra* note 33, art. 6.10.

94. *Id.*

95. *Id.*

96. *Certain Headwear from the People’s Republic of China*, 54 Fed. Reg. 11983, 11986 (Dep’t of Comm. Mar. 23, 1989) (final determination of sales at less than fair value).

97. *Id.*

98. *Id.* (citing *Shop Towels from the People’s Republic of China*; Final Results of Administrative Review of Antidumping Duty Order (50 FR 26020, June 24, 1985)).

99. See *Heavy Forged Hand Tools, Finished or Unfinished, With or Without Handles, from the People’s Republic of China*, 56 Fed. Reg. 241, 244 (Dep’t of Comm. Jan. 3, 1991) (final determinations of sales at less than fair value).

The USDOC asserted that the Chinese national trading company in question failed to submit adequate documentation of its claim that the three exporters were independent corporations.<sup>100</sup> This failure, according to the USDOC, left “no alternative than to treat the three as branches of the same exporting entity.”<sup>101</sup>

Shortly afterwards, the USDOC doubled-down on its denial of separate rates for Chinese exporters. In *Iron Construction Castings from the People's Republic of China*, the USDOC assigned one country-wide antidumping rate to two exporters that were former branches of another Chinese national trading company.<sup>102</sup> The assignment of a country-wide rate in this case is all the more striking as it reversed the USDOC's preliminary decision in the same case to calculate separate rates for the two exporters.<sup>103</sup> More significantly, the USDOC broadly stated in this case that in a state-controlled economy, “all entities are presumed to export under the control of the state” and this presumption can be rebutted only by “a clear showing of legal, financial and economic independence.”<sup>104</sup>

Later in the same year, in *Sparklers from the People's Republic of China*, the USDOC elaborated on its criteria for separate rates for exporters from NME countries.<sup>105</sup> To qualify for company-specific rates, exporters from NME countries have to pass a two-pronged test by demonstrating “an absence of central government control, both in law and in fact, with respect to exports.”<sup>106</sup> For each of the two prongs of the test—referred to by the USDOC as “*de jure* absence of control” and “*de facto* absence of control”—the USDOC set forth a list of evidence supporting, but not requiring, a finding of absence of central control.<sup>107</sup>

---

100. *Id.* The Chinese national trading company in question claimed that it was divided into seven independent corporations pursuant to a government order. The USDOC repeatedly requested a copy of the government order or other official Chinese government documentation at the time of or prior to the date of the order. The national trading company never submitted such documentation. *See id.*

101. *Id.*

102. *See Iron Construction Castings from the People's Republic of China*, 56 Fed. Reg. 2742, 2744 (Dep't of Comm. Jan. 24, 1991) (Final Results of Antidumping Duty Administrative Review).

103. *See id.* at 2743-44. The USDOC stated that after it made its preliminary decision to assign separate rates to the two exporters, “[s]ubsequent review of the information on the record has led us to reevaluate the claims made by [the two exporters] with respect to separation and independence from the national corporation.” *Id.* at 2743. This reevaluation found no information on the record indicating that “the national import/export corporations are independent from one another.” *Id.* at 2744.

104. *Id.*

105. *See Sparklers from the People's Republic of China*, 56 Fed. Reg. 20,588, 20,589 (Dep't of Comm. May 6, 1991) (Final Determination of Sales at Less Than Fair Value).

106. *Id.*

107. According to the USDOC:

Evidence supporting, though not requiring, a finding of *de jure* absence of central control includes: (1) An absence of restrictive stipulations associated with an individual exporter's business and export licenses; (2) any legislative enactments

By now, the USDOC's rejection of separate rates for Chinese companies had progressed from a facts-based decision for specific companies to a presumed norm for all Chinese entities. From this point on, all Chinese companies, regardless of whether they had been historically part of the same national trading company, had to overcome the presumption of central government control in order to obtain separate antidumping rates.<sup>108</sup>

Ironically, the move towards country-wide antidumping rates for Chinese companies took place at a time when China was undergoing rapid economic reforms that conferred higher degrees of independence from the government on Chinese firms.<sup>109</sup> Arguably, the adoption of country-wide antidumping rates for Chinese products comports not with economic principles, but with protectionist policy needs. In calculating country-wide antidumping rates, the USDOC often relies on information provided by petitioners and inferences adverse to respondents.<sup>110</sup> As a result, country-wide antidumping rates tend to be much

---

decentralizing control of companies; or (3) any other formal measures by the government decentralizing control of companies. De facto absence of central government control with respect to exports is based on two prerequisites: (1) Whether each exporter sets its own export prices independently of the government and other exporters; and (2) whether each exporter can keep the proceeds from its sales.

*Id.*

108. Subsequent to *Sparklers*, the USDOC tinkered with its separate-rate criteria as applied to Chinese companies. In *Certain Compact Ductile Iron Waterworks Fittings and Accessories Thereof from the People's Republic of China* in 1993, the USDOC determined that state ownership per se precluded a finding of absence of government control. See 58 Fed. Reg. 37,908, 37,909 (Dep't of Comm. Jul. 14, 1993) (Final Determination of Sales at Less Than Fair Value). According to the USDOC, "an entity cannot be completely free of central government control with respect to exports if it is owned by the central government, regardless of whether the indicia set forth in *Sparklers* have been met." This deviation from the *Sparklers* test, however, was short-lived. In *Silicon Carbide from the People's Republic of China* in 1994, the USDOC changed course and determined that "the ownership of [respondent companies] 'by all the people,' in and of itself, cannot be considered as dispositive in determining whether those companies can receive separate rates." 59 Fed. Reg. 22,585, 22,586 (Dep't of Comm. May 2, 1994) (Notice of Final Determination of Sales at Less Than Fair Value). Therefore, a Chinese respondent could still receive a separate rate "if it establishes on a *de jure* and *de facto* basis that there is an absence of governmental control." *Id.* at 22,587. The USDOC then amplified the *Sparklers* test by adding two factors to the *de facto* analysis: (1) whether the respondent has authority to negotiate and sign contracts and other agreements, and (2) whether the respondent has autonomy from the central government in making decisions regarding selection of management. *Id.* For more detailed discussions of the evolution of the USDOC's separate-rate methodology, see Priya Alagiri, *Reform, Reality, and Recognition: Reassessing U.S. Antidumping Policy Toward China*, 26 L. & POL'Y INT'L BUS. 1061, 1068-79 (1995).

109. See Alagiri, *supra* note 108, at 1082-85 (discussing changes in the Chinese economy in 1989-1994); see also Wentong Zheng, *Transplanting Antitrust in China: Economic Transition, Market Structure, and State Control*, 32 U. PA. J. INT'L L. 643, 652-54, 662-67 (2010) (discussing price liberalization and reforms of state-owned enterprises in China).

110. For Chinese respondents that have not demonstrated an absence of central government control, the USDOC relies on the Chinese government to identify them and to submit a consolidated questionnaire response on their behalf. But it is difficult for the Chinese government to persuade all exporters of the subject merchandise to provide information needed for the consolidated questionnaire response. See Alagiri, *supra* note 108, at 1068. The USDOC may base the country-wide antidumping rate on adverse facts available when some exporters that are part of the NME-wide entity do not respond to the antidumping questionnaire. See *2015 Antidumping Manual*, U.S.

higher than company-specific antidumping rates. According to a 2006 study by the U.S. Government Accountability Office, the USDOC imposed antidumping duties on the same product from both China and one or more market-economy countries in twenty-five cases.<sup>111</sup> The average antidumping rate applied to Chinese companies in the twenty-five cases was over twenty percent higher than the average rate applied to market-economy companies.<sup>112</sup> Much of this difference is attributable to the unusually high country-wide rates for Chinese companies. While company-specific rates for Chinese companies were similar to those assigned to market-economy companies, country-wide rates for Chinese companies were over sixty percent higher than comparable market-economy rates.<sup>113</sup>

The main problem with country-wide antidumping rates, however, is that their legal basis is questionable. In 2009, China mounted its first attack on country-wide antidumping rates before the WTO in *European Communities-Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China (EC-Fasteners)*.<sup>114</sup> China argued, among other things, that the European Union's imposition of country-wide antidumping rates on Chinese products solely because China is an NME country violated the EU's obligations under the WTO Antidumping Agreement and other WTO agreements.<sup>115</sup>

By way of background, the European Union operates an antidumping scheme similar to the country-wide antidumping rate scheme in place in the United States. Article 9(5) of Council Regulation (EC) No. 1225/2009 of 30 November 2009 (EU Basic Antidumping Regulations) provides that when a supplier is from an NME country, the antidumping authority will specify an antidumping duty for the entire supplying country unless the supplier can demonstrate sufficient independence from the government.<sup>116</sup> This is often referred to as the "Individual Treatment" test in EU antidumping law.<sup>117</sup>

---

DEPARTMENT OF COMMERCE IMPORT ADMINISTRATION at 7 (2015), <http://enforcement.trade.gov/admanual/2015/Chapter%2010%20NME.pdf>.

111. UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, U.S.-CHINA TRADE: ELIMINATING NONMARKET ECONOMY METHODOLOGY WOULD LOWER ANTIDUMPING DUTIES FOR SOME CHINESE COMPANIES 16 (2006).

112. *Id.* at 19.

113. *Id.* at 20-21.

114. *See* Request for Consultation, European Communities-Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China, WT/DS397/1 (Aug. 4, 2009).

115. *Id.* at 1-2.

116. *See* Council Regulation (EC) No. 1225/2009 of 30 November 2009 on Protection Against Dumped Imports from Countries Not Members of the European Community, Art. 9(5) [hereinafter EU Basic Antidumping Regulations]. To receive company-specific rates, NME suppliers must demonstrate that:

- “(a) in the case of wholly or partly foreign owned firms or joint ventures, exporters are free to repatriate capital and profits;
- (b) export prices and quantities, and conditions and terms of sale are freely determined;
- (c) the majority of the shares belong to private persons; state officials appearing on the

In *EC-Fasteners*, the WTO Appellate Body addressed the compatibility of the EU's Individual Treatment test with relevant WTO provisions, particularly Article 6.10 of the WTO Antidumping Agreement. The Appellate Body examined the language of Article 6.10 and concluded that the use of the terms "shall" and "as a rule" in the first sentence of Article 6.10 expresses a mandatory obligation, not a mere preference, to determine company-specific dumping margins.<sup>118</sup> This obligation, according to the Appellate Body, is subject only to the exception to use sampling as provided for in the second sentence of Article 6.10 and additional exceptions allowed in other WTO agreements.<sup>119</sup> The Appellate Body found no provisions in relevant WTO agreements that would allow a WTO member to depart from the obligation to determine company-specific dumping margins only with respect to imports from NMEs.<sup>120</sup> In particular, the Appellate Body rejected the EU's efforts to justify its country-wide antidumping rate scheme under Article 15(d) of the China Accession Protocol. The Appellate Body concluded that while Article 15 of the China Accession Protocol establishes special rules regarding the use of surrogate values, "it does not contain an open-ended exception that allows WTO Members to treat China differently for other purposes under the Anti-Dumping Agreement and the GATT 1994, such as the determination of export prices or individual versus country-wide margins and duties."<sup>121</sup> The Appellate Body finally found that the EU's Individual Treatment test, as provided for in Article 9(5) of the EU Basic Antidumping Regulations, is inconsistent with Article 6.10 of the WTO Antidumping Agreement because "it conditions the determination of individual dumping margins for and the imposition of individual anti-dumping duties on NME exporters or producers to the fulfilment of the [Individual Treatment] test."<sup>122</sup>

The Appellate Body's ruling on country-wide antidumping rates in *EC-Fasteners* rejected a long-standing practice that was essential to keeping

---

board of directors or holding key management positions shall either be in minority or it must be demonstrated that the company is nonetheless sufficiently independent from State interference;

(d) exchange rate conversions are carried out at the market rate; and

(e) State interference is not such as to permit circumvention of measures if individual exporters are given different rates of duty."

*Id.*

117. See, e.g., Chad P. Bown & Petros C. Mavroidis, *One (Firm) is Not Enough: A Legal-Economic Analysis of EC-Fasteners*, 12 *WORLD TRADE REV.* 243, 244 (2013).

118. Report of the Appellate Body, *European Communities-Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China*, WT/DS397/AB/R (Jul. 15, 2011), ¶¶ 315-17 [hereinafter *EC-Fasteners AB Report*].

119. *Id.* ¶ 320.

120. *Id.* ¶ 328.

121. *Id.* ¶ 290.

122. *Id.* ¶ 385. The Appellate Body also addressed the compatibility of Article 9(5) of the EU Basic Antidumping Regulations with other WTO provisions, such as Article 9.2 of the WTO Antidumping Agreement and Article I:1 of the GATT 1994. See *id.* ¶¶ 330-54, 386-98.

antidumping duties high for Chinese products.<sup>123</sup> What prompted the Appellate Body to take this dramatic step appears to be the fact that the relevant WTO provisions on this issue are relatively clear. The way the provisions were drafted simply does not allow for the calculation of country-wide antidumping rates merely because the suppliers are from NME countries.<sup>124</sup> To hold otherwise in the face of such textual clarity would strain the credibility of the rule-based world trade system. In the perpetual tug-of-war between free trade principles and protectionism, the former won an important battle.<sup>125</sup>

### B. Countervailing Duty Law

Besides antidumping, another area of trade law that has seen constant tussles between free trade principles and protectionism in the face of China's threats to the existing world trade order is countervailing duty law. Due to concerns about the systemic coherence of trade law, the United States had resisted the idea of applying countervailing duty law to Chinese products, until the level of protection offered by antidumping alone became inadequate to cope with surging imports from China. The application of countervailing duty law to Chinese products raises a host of thorny issues, including the potential double-counting of subsidies, the determination of whether a firm is a "public body" capable of conferring subsidies, and the use of cross-border benchmarks in measuring the magnitudes of subsidies. As discussed below, the WTO's handling of these issues further disturbed the already delicate balance struck by trade law with respect to China.

#### 1. To Countervail or to Not Countervail?

As a threshold matter, the basic WTO rules governing countervailing duties—Article VI of the GATT and the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement)—place no limitations on the reach of countervailing duty law. However, the USDOC, the U.S. agency responsible for assessing antidumping and countervailing duties, initially chose not to apply countervailing duty law to imports from NMEs. In 1984, the USDOC laid out its

---

123. For the importance of country-wide antidumping rates to antidumping authorities, see *supra* notes 111-113 and accompanying text.

124. It is not clear why the use of country-wide antidumping rates for Chinese companies, which predated China's entry into the WTO, was not explicitly recognized and sanctioned in the China Accession Protocol. As the Appellate Body in *EC-Fasteners* observed, Paragraph 15 of the China Accession Protocol only concerns the use of surrogate values, not the use of country-wide antidumping rates, for Chinese companies. The failure to explicitly provide for a central antidumping tool in China's Accession Protocol is likely an oversight on the part of Western trade negotiators and treaty drafters.

125. In June 2012, the European Union implemented the Appellate Body's findings in DS397 with respect to country-wide antidumping rates by eliminating the presumption of non-independence from the state for producers from NME countries. See Regulation (EU) No. 765/2012 of the European Parliament and of the Council of 13 June 2012, <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32012R0765>.



position on countervailing duties for NME countries in *Carbon Steel Wire Rod from Poland*.<sup>126</sup> The USDOC asserted that subsidies, which it defined as “any action that distorts or subverts the market process and results in a misallocation of resources,”<sup>127</sup> were a meaningless concept in NME countries because those countries had no market processes to be distorted or subverted to begin with.<sup>128</sup> The U.S. Court of Appeals for the Federal Circuit upheld this determination in the landmark case of *Georgetown Steel Corp. v. United States* in 1986.<sup>129</sup> After examining the purpose of countervailing duty law, the nature of nonmarket economies, and the action Congress had taken in other statutes that specifically addressed the question of imports from NMEs, the Federal Circuit concluded that the economic incentives and benefits provided by the NMEs in question for exports to the United States did not constitute subsidies within the meaning of U.S. countervailing duty law.<sup>130</sup>

As discussed in Part II.A.1 above, in the early 1990s, the USDOC briefly recognized some Chinese domestic prices as market-driven and therefore used them for price comparisons in antidumping proceedings. The USDOC was then confronted with the question of whether the same market forces it recognized as being present in China should lead to the conclusion that countervailing duty law should be applied to China.<sup>131</sup> The USDOC eventually said no to this question, and opted to reverse its uses of actual Chinese prices in antidumping for the sake of trade law’s internal coherence.<sup>132</sup>

Arguably, the USDOC was able to withstand pressure to impose countervailing duties on Chinese products on top of antidumping duties in the 1980s and early 1990s because such pressure was not severe enough at the time. Fast forwarding twenty-five years, when U.S. petitioners tried again to impose countervailing duties on Chinese products, the USDOC changed course. In a 2007 policy memorandum, the USDOC examined whether the analytical elements of the Federal Circuit’s *Georgetown Steel* decision were still applicable to China’s present-day economy.<sup>133</sup> The USDOC stated that China’s economy at the time was “significantly different” from the Soviet-style economies at issue in *Georgetown Steel*.<sup>134</sup> China’s economy was more flexible, said the USDOC,

---

126. *Carbon Steel Wire Rod from Poland*, 49 Fed. Reg. 19,374 (Dep’t of Comm. May 7, 1984) (final negative countervailing duty determination).

127. *Id.* at 19,375.

128. *Id.*

129. *See Georgetown Steel Corp. v. United States*, 801 F.2d 1308 (Fed. Cir. 1986).

130. *Id.* at 1313-18.

131. *See supra* note 77 and accompanying text.

132. *See supra* note 81 and accompanying text.

133. *See* Memorandum from Shauna Lee-Alaia & Lawrence Norton, Office of Policy, Import Admin., to David M. Spooner, Asst. Sec’y, Import Admin., Countervailing Duty Investigation of Coated Free Sheet Paper from the People’s Republic of China—Whether the Analytical Elements of the *Georgetown Steel* Opinion are Applicable to China’s Present-Day Economy (Mar. 29, 2007) [hereinafter *Georgetown Steel Memo*].

134. *Id.* at 4.

than the Soviet-style economies in terms of the power to set wages and prices, access to foreign currency, personal property rights and private entrepreneurship, foreign trading rights, and allocation of financial resources.<sup>135</sup> As a result, the USDOC concluded that “it is possible to determine whether the PRC Government has bestowed a benefit upon a Chinese producer (i.e., the subsidy can be identified and measured) and whether any such benefit is specific.”<sup>136</sup>

It could be argued that the USDOC’s decision to apply countervailing duty law to China was based on principles, not on expediency. After all, it is undeniable that China’s economy in 2007 had undergone dramatic transformations since the 1980s. The policy of not applying countervailing duty law to NMEs—a policy rooted in the conceptualization of NMEs as Soviet-style economies—arguably no longer reflected China’s economic reality.

What made the USDOC’s move problematic, however, is that while the USDOC recognized market forces in China for countervailing duty purposes, it continually refused to recognize market forces in China for antidumping purposes. In 2006, in its latest assessment of whether China should continue to be designated as an NME, the USDOC determined that “market forces in China are not yet sufficiently developed to permit the use of prices and costs in that country for purposes of the Department’s dumping analysis.”<sup>137</sup> A year later, in its *Georgetown Steel* memorandum, which concluded that countervailing duty law now applied to China, the USDOC acknowledged that “[t]he features and characteristics of China’s present-day economy also suggest that modification of some aspects of the Department’s current NME antidumping policy and practice may be warranted, such as the conditions under which the Department might grant an NME respondent market economy treatment.”<sup>138</sup> In 2007, the USDOC issued requests for public comments on how it might be able to grant market-economy treatment to individual Chinese respondents in antidumping proceedings.<sup>139</sup> These requests for comments, however, have not resulted in any concrete action on the part of the USDOC. As such, the USDOC’s policy towards China is caught in an obvious contradiction: Market forces in China are considered strong enough for subsidies to be identified and measured, but not strong enough for Chinese domestic prices or costs to be used as the basis of

---

135. *Id.* at 5-9.

136. *Id.* at 10. After determining that the Chinese government had granted a subsidy, the USDOC could then potentially apply countervailing duty law to Chinese imports.

137. Shauna Lee-Alaia et al., Imp. Admin., Antidumping Duty Investigation of Certain Lined Paper Products from the People’s Republic of China (China)—China’s Status as a Non-Market Economy (NME) 4 (2006), <http://enforcement.trade.gov/download/prc-nme-status/prc-lined-paper-memo-08302006.pdf>.

138. *Georgetown Steel Memo*, *supra* note 133, at 11.

139. Antidumping Methodologies in Proceedings Involving Certain Non-Market Economies: Market-Oriented Enterprise, 72 Fed. Reg. 29,302 (Dep’t of Comm. May 25, 2007) (request for comment); Antidumping Methodologies in Proceedings Involving Certain Non-Market Economies: Market-Oriented Enterprise: Request for Comment, 72 Fed. Reg. 60,649 (Dep’t of Comm. Oct. 25, 2007).

comparison in antidumping. While one could explain away this contradiction by pointing to the hybrid nature of China's economy today, a more plausible interpretation appears to be that the USDOC's new policy serves the needs to maintain maximum levels of protection against Chinese products.

## 2. Double Counting

After the USDOC started applying countervailing duty law to imports from China, Chinese respondents filed legal actions in both U.S. domestic courts and international venues to challenge the simultaneous imposition of countervailing and antidumping duties calculated using the surrogate-value methodology. One central issue raised in these legal actions was whether the amount of antidumping duties calculated using the surrogate-value methodology already captures subsidies that may have been conferred on the subject merchandise. If so, then the subsidies would have been double-counted, once through the countervailing duties and once through the antidumping duties. As discussed in detail below, litigation over the double-counting issue forced the USDOC to roll back some, but not all, of the countervailing duties imposed on Chinese products.

Initially, Chinese respondents attempted to have U.S. courts strip the USDOC of its authority to apply countervailing duty law to imports from China altogether. In *GPX International Tire Corp. v. United States* ("GPX I"), decided in September 2009, Chinese respondents argued that the U.S. countervailing duty statute barred the application of countervailing duty law to imports from NMEs.<sup>140</sup> The U.S. Court of International Trade (CIT) disagreed. Citing the ambiguity in both the Federal Circuit's *Georgetown Steel* ruling and the countervailing duty law itself regarding the applicability of the countervailing duty law to NMEs, the CIT stated that it "cannot say from the statutory language alone that Commerce does not have the authority to impose [countervailing duties] on products from an NME-designated country."<sup>141</sup>

While Chinese respondents' argument that the USDOC lacked statutory authority to apply countervailing duty law to NME imports floundered, their alternative argument regarding double-counting gained traction in U.S. courts. In *GPX I*, the Chinese plaintiff argued that "double counting occurs when Commerce imposes a CVD remedy to offset an alleged government subsidy, but then compares a subsidy-free constructed normal value (essentially using information from surrogate countries) with the original subsidized export price to calculate the AD margin."<sup>142</sup> Imposing countervailing duties on top of the antidumping duties, according to the plaintiff, will therefore result in the double counting and double remedy of the subsidies.<sup>143</sup> The CIT in *GPX I* turned out to

---

140. 645 F.Supp.2d 1231, 1236-40 (Ct Int'l Trade 2009) (discussing whether the USDOC has the statutory authority to apply countervailing duty law to imports from NMEs) [hereinafter *GPX I*].

141. *Id.* at 1239.

142. *Id.* at 1241.

143. *Id.* For detailed illustrations of why double counting might occur in simultaneous

be highly receptive to this analysis. The CIT stated that under the surrogate-value method, “the export price is not being compared with the price of the good in the PRC in which case both sides of the comparison would be equally affected, but rather, export price, however it is affected by the subsidy, is compared with the presumptively subsidy-free constructed normal value.”<sup>144</sup> Without some type of adjustment, therefore, the simultaneous imposition of antidumping duties and countervailing duties in this situation “could very well result in a double remedy.”<sup>145</sup> The CIT went on to hold that “if . . . it is too difficult for Commerce to determine whether, and to what degree double counting is occurring, Commerce should refrain from imposing CVDs on NME goods until it is prepared to address this problem through improved methodologies or new statutory tools.”<sup>146</sup> The CIT remanded the case back to the USDOC, requiring the USDOC to either forego the imposition of countervailing duties on the Chinese products at issue or to adopt additional policies and procedures to address the double-counting issue.<sup>147</sup>

In its remand determination issued in response to the CIT ruling in *GPX I*, the USDOC explored ways to avoid the double remedy of subsidies for Chinese products.<sup>148</sup> The USDOC concluded that it had three options: It could choose not to apply countervailing duty law to Chinese products, choose to apply the market economy antidumping methodology to Chinese products, or apply both countervailing duty law and the NME antidumping methodology to Chinese products but use the countervailing duties to offset the antidumping duties.<sup>149</sup> The DOC adopted the third option because it believed that it was “the least objectionable of the three.”<sup>150</sup>

Upon appeal of the USDOC’s remand determination, in August 2010, the CIT once again rejected the USDOC’s handling of the double-counting issue. In *GPX International Corp. v. United States (GPX II)*, the CIT observed that under the offset proposed by the USDOC, the combined antidumping and countervailing duties will always equal the unaltered antidumping duties.<sup>151</sup> This, according to the CIT, “renders concurrent CVD and AD investigations unnecessary because the same remedial price adjustment can otherwise be

---

antidumping and countervailing duty cases involving NME products, see Wentong Zheng, *Counting Once, Counting Twice: The Precarious State of Subsidy Regulation*, 49 STAN. J. INT’L L. 427, 439-40 (2013).

144. *GPX I*, *supra* note 140, at 1242.

145. *Id.*

146. *Id.* at 1243.

147. *Id.* at 1251.

148. Dep’t of Commerce, Final Results of Redetermination Pursuant to Remand (2010), <http://ia.ita.doc.gov/remands/09-103.pdf>.

149. *Id.* at 8.

150. *Id.* For discussions of why the USDOC found the first two options to be more objectionable, *see id.* at 8-9.

151. *GPX Int’l Corp. v. United States*, 715 F. Supp. 2d 1337, 1345 (Ct. Int’l Trade 2010) [hereinafter *GPX II*].

obtained by merely conducting an NME AD investigation.”<sup>152</sup> The CIT agreed with the Chinese plaintiffs that “it is not reasonable to ‘force[] foreign parties to spend many months and large sums of money to go through an investigation, the end result of which is to calculate a CVD margin, but then to eliminate that CVD [margin] because it has been offset by some parallel investigation.”<sup>153</sup> The CIT further held that the proposed offset had no legal basis in U.S. antidumping law anyway.<sup>154</sup> Given the USDOC’s inability to determine whether and to what degree double counting was occurring, the CIT held that the only option left for the USDOC was not to apply the countervailing duty law to imports from China.<sup>155</sup>

In December 2011, in *GPX International Corp. v. United States (GPX III)*, the Federal Circuit affirmed the CIT’s *GPX II* ruling, but on a different ground.<sup>156</sup> The Federal Circuit was far more skeptical than the CIT about the entire double-counting argument. It expressed doubts about whether U.S. law prohibited double-counting, and gave credence to the fact that the USDOC had determined that it was not clear whether double counting had in fact occurred.<sup>157</sup> But the Federal Circuit still held that U.S. countervailing duty law barred the imposition of countervailing duties on imports from NMEs because of the principle of legislative ratification. Since Congress amended U.S. trade law many times after the *Georgetown Steel* decision, but did not make any changes that would have altered the USDOC’s handling of countervailing duty law for NME imports, the Federal Circuit concluded that Congress ratified the USDOC’s then-prevailing policy of not applying countervailing duty law to NME imports.<sup>158</sup> If the USDOC believed that countervailing duty law should apply to NME imports, said the Federal Circuit, then “the appropriate approach would be to seek legislative change.”<sup>159</sup>

While the *GPX* litigation was pending in U.S. courts, the Chinese government filed claims before the WTO against the USDOC’s simultaneous application of NME antidumping and countervailing duties to Chinese products. In October 2010 a WTO dispute settlement panel issued DS379, its final report

---

152. *Id.*

153. *Id.* The CIT did not explain why the respondents could not simply ignore the countervailing duty proceedings. Arguably, this is because the combined antidumping and countervailing duty rate will equal the unaltered antidumping rate only if the countervailing duty rate is less than the unaltered antidumping rate. If the countervailing duty rate is greater than the unaltered antidumping rate, the combined antidumping and countervailing duty rate will equal the countervailing duty rate. The respondents could not ignore the countervailing duty proceedings, because there is a possibility that the combined rate will be determined by the countervailing duty rate.

154. *Id.*

155. *Id.* at 1346.

156. *GPX Int’l Tire Corp. v. United States*, 666 F.3d 732 (Fed. Cir. 2011) [hereinafter *GPX III*].

157. *See id.* at 737.

158. *Id.* at 739-45.

159. *Id.* at 745.

in which China pressed its double-counting claims.<sup>160</sup> The panel acknowledged the theoretical possibility of double counting, noting that the use of the NME antidumping methodology leads to “an asymmetric dumping margin comparison between an *unsubsidized* normal value and *subsidized* export price.”<sup>161</sup> This, in turn, led the panel to believe that “at least *some* double remedy will *likely* arise from the concurrent imposition of countervailing duties and antidumping duties calculated under an NME methodology.”<sup>162</sup> That said, however, the panel went on to hold that even if double counting did occur, it was not inconsistent with any of the WTO provisions cited by China and therefore raised no issues under WTO law.<sup>163</sup>

Upon appeal of the WTO panel’s ruling in DS379, China found a more friendly audience for its double-counting claims at the WTO Appellate Body. In its final report issued in March 2011, the Appellate Body reversed the panel’s findings as to whether WTO law prohibited double counting.<sup>164</sup> Specifically, the Appellate Body held that the panel erred in its interpretation of Article 19.3 of the SCM Agreement,<sup>165</sup> which requires a countervailing duty to be imposed in the “appropriate” amounts.<sup>166</sup> The Appellate Body stated that “the amount of a countervailing duty cannot be ‘appropriate’ in situations where that duty represents the full amount of the subsidy and where antidumping duties, calculated at least to some extent on the basis of the same subsidization, are imposed concurrently to remove the same injury to the domestic industry.”<sup>167</sup> The Appellate Body then recognized that the occurrence of double counting depended on “whether and to what extent domestic subsidies have lowered the export price of a product, and on whether the investigating authority has taken the necessary corrective steps to adjust its methodology to take account of this factual situation.”<sup>168</sup> In the USDOC proceedings at issue, however, the USDOC “did not initiate any examination of whether double remedies would arise . . .

---

160. See Report of the Panel, United States-Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, WT/DS379/R (Oct. 22, 2010) [hereinafter *DS379 Panel Report*].

161. *Id.* ¶ 14.72 (emphasis original).

162. *Id.* ¶ 14.75 (emphasis original).

163. *Id.* ¶ 14.76. China argued that double counting was inconsistent with Articles 10, 19.3, 19.4 and 32.1 of the SCM Agreement and Articles VI:3 and I:1 of the GATT 1994. The panel rejected all of these arguments. See *id.* at 14.104-.140, .144-.149, .164-.182.

164. See Report of the Appellate Body, United States-Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, WT/DS379/AB/R (Mar. 11, 2011), ¶¶ 545-91 [hereinafter *DS379 AB Report*].

165. *Id.* ¶ 582.

166. WTO Agreement on Subsidies and Countervailing Measures, 1869 U.N.T.S. 14, art. 19.3 [hereinafter *SCM Agreement*] (“When a countervailing duty is imposed in respect of any product, such countervailing duty shall be levied, in the appropriate amounts in each case, on a non-discriminatory basis on imports of such product from all sources found to be subsidized and causing injury . . .”).

167. DS379 AB Report, *supra* note 164, ¶ 582.

168. *Id.* ¶ 599.

and refused outright to afford any consideration to the issue or to the submissions pertaining to the issue that were presented to it.”<sup>169</sup> The Appellate Body found this failure to conduct any factual inquiries as to the double-counting issue to be inconsistent with the requirement of Article 19.3 of the SCM Agreement.<sup>170</sup>

Confronted with two adverse rulings on the application of U.S. countervailing duty law to imports from NMEs, one by the Federal Circuit and one by the WTO Appellate Body, the United States Congress took up the task of amending U.S. countervailing duty law by enacting Public Law 112-99 (P.L. 112-99) in March 2012.<sup>171</sup> In P.L. 112-99, Congress overrode the Federal Circuit’s ruling in *GPX III* and explicitly provided that U.S. countervailing duty law applied to imports from NMEs.<sup>172</sup> To comply with the Appellate Body’s ruling in DS379, P.L. 112-99 added a new provision to U.S. countervailing duty law requiring the USDOC to reduce the antidumping duty amount by the amount of countervailable subsidies that are demonstrated to have been double-counted.<sup>173</sup>

In July 2012, pursuant to the new statutory requirements set forth in P.L. 112-99, the USDOC issued its amended determinations for the antidumping and countervailing duty proceedings challenged in DS379.<sup>174</sup> In the amended determinations, the USDOC allocated to the Chinese respondents the burden of demonstrating their entitlement to adjustments to their antidumping duty rates.<sup>175</sup> The USDOC considered the Chinese respondents to have met this burden with respect to certain input subsidies, namely, subsidies on inputs used in the manufacturing of the subject merchandise.<sup>176</sup> The USDOC calculated the amount of the input subsidies that had been double-counted as being sixty-three

---

169. *Id.* ¶ 604.

170. *Id.* ¶ 606.

171. See Act of Mar. 13, 2012, Pub. L. No. 112-99, 126 Stat. 265 [hereinafter P.L. 112-99].

172. *Id.* section 1(a) (“[T]he merchandise on which countervailing duties shall be imposed under [section 701(a) of the Tariff Act of 1930] includes a class or kind of merchandise imported, or sold (or likely to be sold) for importation, into the United States from a nonmarket economy country.”).

173. *Id.* section 2(a). The new provision requires the USDOC to adjust the antidumping duty amount only if the countervailing duty “has been demonstrated to have reduced the average price of imports of the class or kind of merchandise,” and the USDOC can “reasonably estimate” the extent to which the countervailing duty has increased the antidumping duty.

174. See Circular Welded Carbon Quality Steel Pipe from the People’s Republic of China (Dep’t of Commerce July 31, 2012) (final section 129 determination) [hereinafter CWP Section 129 Determination], <http://ia.ita.doc.gov/download/section129/prc-cwcq-steel-pipe-Final-129-Determination-20120830.pdf>; Certain New Pneumatic Off-the-Road Tires from the People’s Republic of China (Dep’t of Commerce July 31, 2012) (final section 129 determination), <http://ia.ita.doc.gov/download/section129/prc-otr-tires-Final-129-Determination-20120830.pdf>; Laminated Woven Sacks from the People’s Republic of China (Dep’t of Commerce July 31, 2012) (final section 129 determination), <http://ia.ita.doc.gov/download/section129/prc-lw-sacks-Final-129-Determination-20120830.pdf>.

175. See, e.g., CWP Section 129 Determination, *supra* note 174, at 14.

176. *Id.* at 14-15.

percent of the subsidies.<sup>177</sup> As a result, the USDOC subtracted sixty-three percent of the input subsidies from the amount of the antidumping duties.<sup>178</sup>

In sum, through its legal maneuvers on the double-counting issue, China succeeded in forcing the United States to scale back some of the countervailing duties it had newly imposed on Chinese products. In the face of highly complex economic issues surrounding the double-counting issue,<sup>179</sup> the WTO Appellate Body took a cautious approach and required member countries to at least take cognizance of the double-counting issue. The WTO's willingness to reject a trade practice on the basis of the mere possibility of unfairness manifests its preference to err on the side of overreaction for the sake of sound principles. But at the same time, the United States was able to impose at least some countervailing duties on top of antidumping duties for Chinese products, with the end result being a higher level of protection against Chinese products.

### 3. *Public Body*

Aside from the threshold questions of whether countervailing duty law applies to Chinese products and whether they have been double-counted, countervailing duty investigating authorities from around the world also have to grapple with questions that are of a technical nature but have a big impact on the way countervailing duties are assessed for Chinese products. One such technical question is whether Chinese state-owned enterprises and banks should be considered "public bodies" and therefore capable of conferring subsidies within the meaning of the SCM Agreement. As discussed below, the hybrid nature of the Chinese economy created an opening for importing countries to interpret the term "public body" in ways that made it easier to prove the existence of a countervailable subsidy. The WTO, however, rejected some of those interpretations and required more evidence than mere government ownership in determining whether a Chinese entity is a public body.

Under the SCM Agreement, only a government or public body is capable of directly giving subsidies.<sup>180</sup> If a private body is accused of giving a subsidy, it must be demonstrated that a government "entrusts or directs" the private body to carry out a function that "would normally be vested in the government" and the practice followed by the private body "in no real sense . . . differs from practices normally followed by governments."<sup>181</sup>

---

177. *Id.* at 19. In arriving at this number, the USDOC compared the ratio of change between input prices as proxied by an aggregate-level China purchasing price index and output prices as proxied by an aggregate-level China production price index. *See id.* at 18-19.

178. *Id.* at 35-36.

179. For discussions of the economics behind the double-counting issue, see Wentong Zheng, *Counting Once, Counting Twice: The Precarious State of Subsidy Regulation*, 49 STAN. J. INT'L L. 427, 450-58 (2013).

180. SCM Agreement, *supra* note 166, art. 1.1(a)(1) ("[A] subsidy shall be deemed to exist if . . . there is a financial contribution by a government or any public body within the territory of a Member . . .") (emphasis added).

181. *Id.* 1.1(a)(1)(iv).



The interpretation of the term “public body,” which the SCM Agreement does not define, proved to be a particularly thorny issue in U.S. countervailing duty proceedings involving Chinese state-owned enterprises (SOEs) or state-owned commercial banks (SOCBs). Some of the subsidies alleged in those proceedings were input subsidies given by Chinese SOEs that sold products to downstream producers of the subject merchandise at below-market prices and loan subsidies given by Chinese SOCBs that made loans to producers of the subject merchandise at below-market interest rates.<sup>182</sup> If the SOE input suppliers and SOCB lenders were considered public bodies, then the USDOC would be able to bypass the requirement to show “entrustment or direction” for those entities, making it much easier to prove the existence of a countervailable subsidy.<sup>183</sup>

The USDOC moved precisely in this direction by treating Chinese SOEs and SOCBs as public bodies. In *Light-Walled Rectangular Pipe and Tube from People's Republic of China* in 2008, for example, the USDOC investigated certain Chinese steel producers for allegedly providing input subsidies to downstream steel pipe and tube producers by selling steel products to them for less than adequate remuneration.<sup>184</sup> In determining whether those input suppliers were public bodies, the USDOC refused to apply a five-factor test that it had used in prior cases involving non-Chinese producers, on the grounds that the Chinese government failed to provide sufficient information on factors other

---

182. See, e.g., Memorandum from Stephen J. Claeys, Assistant Sec'y for Import Admin., to David M. Spooner, Deputy Assistant Sec'y for Import Admin., Issues and Decision Memorandum for the Final Affirmative Countervailing Duty Determination: Certain New Pneumatic Off-the-Road Tires (OTR Tires) from the People's Republic of China 9-15 (Jul. 7, 2008), <http://enforcement.trade.gov/frn/summary/PRC/E8-16154-1.pdf> [hereinafter OTR Tires CVD I&D Memo]; Memorandum from Stephen J. Claeys, Assistant Sec'y for Import Admin., to David M. Spooner, Deputy Assistant Sec'y for Import Admin., Issues and Decision Memorandum for the Final Affirmative Countervailing Duty Determination: Laminated Woven Sacks from the People's Republic of China 18-26 (Jun. 16, 2008), <http://enforcement.trade.gov/frn/summary/PRC/E8-14256-1.pdf> [hereinafter LWS CVD I&D Memo]; Memorandum from Stephen J. Claeys, Assistant Sec'y for Import Admin., to David M. Spooner, Deputy Assistant Sec'y for Import Admin., Issues and Decision Memorandum for the Final Determination in the Countervailing Duty Investigation of Light-Walled Rectangular Pipe and Tube from the People's Republic of China 8-9 (Jun. 13, 2008), <http://enforcement.trade.gov/frn/summary/PRC/E8-14250-1.pdf> [hereinafter LWP CVD I&D Memo]; Memorandum from Stephen J. Claeys, Assistant Sec'y for Import Admin., to David M. Spooner, Deputy Assistant Sec'y for Import Admin., Issues and Decision Memorandum for the Final Determination in the Countervailing Duty Investigation of Circular-Welded Carbon Quality Steel Pipe from the People's Republic of China 9-12, 14-15 (May 29, 2008), <http://enforcement.trade.gov/frn/summary/PRC/E8-12606-1.pdf> [hereinafter CWP CVD I&D Memo].

183. Proving “entrustment or direction” is no easy matter. In *US—Countervailing Duty Investigation on DRAMs*, the WTO Appellate Body held that to show “entrustment or direction,” there must be a “demonstrable link between the government and the conduct of the private body.” Report of the Appellate Body, United States-Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMs) from Korea, WT/DS296/AB/R (Jun. 27, 2005), ¶ 112. It further held that “mere policy pronouncements” are insufficient, and that “entrustment and direction” imply “a more active role than mere acts of encouragement” and cannot be “inadvertent or a mere by-product of government regulation.” *Id.* ¶ 114.

184. See LWP CVD I&D Memo, *supra* note 182, at 8-9.

than the government ownership of the input suppliers<sup>185</sup> Instead, for those input suppliers, the USDOC adopted a “majority ownership” rule, under which any input suppliers that were majority owned by the Chinese government were considered public bodies<sup>186</sup> In another case, *Coated Free Sheet Paper from the People's Republic of China* in 2007, the USDOC similarly treated Chinese SOCBs as public bodies on the grounds that the Chinese government maintained near complete state ownership of the banking sector in China and exercised extensive control and influences over the operations of SOCBs.<sup>187</sup>

China challenged the USDOC's public body determinations before the WTO. In DS379, the WTO dispute settlement panel sided with the USDOC with respect to its determinations for both the SOEs and the SOCBs. As for the SOEs, the panel interpreted the term “public body” in Article 1.1(a)(1) of the SCM Agreement as “any entity controlled by a government.”<sup>188</sup> Government ownership, according to the Panel, was “highly relevant (indeed potentially dispositive) evidence of government control.”<sup>189</sup> The panel therefore found “no legal error . . . in giving primacy to evidence of majority government-ownership.”<sup>190</sup> For the same reasons, the panel also upheld the USDOC's determination that the Chinese SOCBs in question were public bodies.<sup>191</sup>

On appeal of the panel's report in DS379, the WTO Appellate Body reversed the panel's finding as to the SOEs but upheld its finding as to the SOCBs. The Appellate Body first disagreed with the panel's equation of public body with government control, stating that “control of an entity by a government, in itself, is not sufficient to establish that an entity is a public body.”<sup>192</sup> The Appellate Body went on to hold that the assessment of whether an entity is a public body “must focus on evidence relevant to the question of whether the entity is vested with or exercises government authority.”<sup>193</sup> According to the Appellate Body, the USDOC's reliance on government ownership in its public body determinations was not sufficient “because evidence of government ownership, in itself, is not evidence of meaningful control of an entity by government and cannot, without more, serve as a basis

---

185. *Id.* at 28-30. The five-factor test the USDOC used in prior cases inquires about the government ownership of an entity, the government's presence on the entity's board of directors, the government's control over the entity's activities, the entity's pursuit of governmental policies or interests, and whether the entity is created by statute. *Id.* at 26-27.

186. *Id.* at 29.

187. See Memorandum from Stephen J. Claeys, Assistant Sec'y for Import Admin., to David M. Spooner, Deputy Assistant Sec'y for Import Admin., on the Issues and Decision Memorandum for the Final Determination in the Countervailing Duty Investigation of Coated Free Sheet Paper from the People's Republic of China 55-61 (Oct. 17, 2007), <http://enforcement.trade.gov/frn/summary/PRC/E7-21046-1.pdf> [hereinafter CFP CVD I&D Memo].

188. DS379 Panel Report, *supra* note 160, ¶ 8.94.

189. *Id.* ¶ 8.134.

190. *Id.* ¶ 8.136.

191. *Id.* ¶¶ 8.142-143.

192. DS379 AB Report, *supra* note 164, ¶ 320.

193. *Id.* ¶ 345.

for establishing that the entity is vested with authority to perform a governmental function.”<sup>194</sup> As for the SOCBs, the Appellate Body noted that the USDOC considered “extensive evidence relating to the relationship between the SOCBs and the Chinese Government, including evidence that the SOCBs are meaningfully controlled by the government in the exercise of their functions.”<sup>195</sup> The Appellate Body concluded that “these considerations, taken together, demonstrate that the USDOC’s public body determination in respect of SOCBs was supported by evidence on the record that these SOCBs exercise governmental functions on behalf of the Chinese Government.”<sup>196</sup>

In a subsequent WTO dispute settlement proceeding, DS437, a WTO dispute settlement panel further clarified the meaning of “public body” in Article 1.1(a)(1) of the SCM Agreement.<sup>197</sup> The panel in DS437 understood the Appellate Body in DS379 “to have found that the critical consideration in identifying a public body is the question of authority to perform governmental functions.”<sup>198</sup> The panel was not persuaded, however, by China’s argument that “[a] public body, like government in the narrow sense, thus must itself possess the authority to ‘regulate, control, supervise or restrain’ the conduct of others.”<sup>199</sup> That interpretation, according to the panel, would equate the term “public body” with the term “government agency,” an approach that the Appellate Body in DS379 did not follow.<sup>200</sup> But at the same time, the panel also rejected a definition of the term “public body” based on “simple ownership or control by a government.”<sup>201</sup> The panel thus concluded that the USDOC acted inconsistently with Article 1.1(a)(1) of the SCM Agreement when it found that Chinese SOEs were public bodies “based solely on the grounds that these enterprises were (majority) owned, or otherwise controlled, by the Government of China.”<sup>202</sup>

In sum, through its interpretations of the term “public body,” the WTO stayed away from automatically treating all Chinese SOEs as part of the Chinese government itself. The WTO took a more nuanced approach that requires inquiries into whether the SOEs exercise governmental functions. While this approach poses hurdles to finding a countervailable subsidy from the business operations of Chinese SOEs, it preserves WTO member countries’ ability to

---

194. *Id.* ¶ 346.

195. *Id.* ¶ 355.

196. *Id.*

197. See Report of the Panel, United States—Countervailing Duty Measures on Certain Products from China, ¶ 7.65–75, WT/DS437/R (July 14, 2014) [hereinafter DS437 Panel Report].

198. *Id.* ¶ 7.66.

199. *Id.* ¶ 7.67.

200. *Id.* ¶ 7.68.

201. *Id.* ¶ 7.68–72.

202. DS437 Panel Report, *supra* note 197, ¶ 7.75. The panel, however, did not address the United States’ argument that the term “public body” should be interpreted to mean “an entity that is controlled by a government such that the government can use the resources of that entity as its own.” See *Id.* ¶ 7.74. The panel considered it unnecessary to evaluate that argument because it was not the basis of the USDOC’s public body determinations in the underlying proceedings. *Id.*

impose countervailing duties if the Chinese SOEs are indeed engaged in activities of governmental nature.

#### 4. *Out-of-Country Benchmarks*

Another issue that has had a tremendous impact on the assessment of countervailing duties for Chinese products is the use of out-of-country or cross-border benchmarks in measuring the magnitudes of subsidies. As discussed below, the extensive role of the Chinese government in China's economy created an opportunity for investigating authorities to discard Chinese domestic prices and opt for third-country prices as the benchmark in calculating the amounts of countervailing duties. Like the use of surrogate values in antidumping, the use of out-of-country benchmarks in countervailing duty proceedings tends to inflate the amounts of countervailing duties and result in a higher level of protection against Chinese products. But as detailed below, China was able to persuade the WTO to reject the use of out-of-country benchmarks in some of the most egregious situations, dealing a setback to investigating authorities and petitioners seeking to take advantage of the WTO's tolerance of such benchmarks.

Under the SCM Agreement, a countervailable subsidy exists only if the alleged subsidy confers a "benefit" on the recipient of the subsidy.<sup>203</sup> The SCM Agreement, however, does not offer a definition of the term "benefit." It only provides guidelines on how to calculate the benefit of a subsidy to the recipient in four scenarios involving the government provision of equity capital, loans, and loan guarantees, and the provision of goods or services or the purchase of goods by a government.<sup>204</sup> In *Canada—Measures Affecting the Export of Civilian Aircraft*, the WTO Appellate Body made clear that the common theme of those guidelines is to identify a subsidy by determining "whether the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market."<sup>205</sup> In *United States-Final Countervailing Duty Determination With Respect to Certain Softwood Lumber from Canada*, the Appellate Body held that under Article 14(d) of the SCM Agreement, which concerns the government provision of goods or services for less than adequate remuneration, an investigating authority "may use a benchmark other than private prices in the country of provision . . . if it is first established that private prices in that country are distorted because of the government's predominant role in providing those goods."<sup>206</sup> This opened the

---

203. SCM Agreement, *supra* note 166, art. 1.1(b).

204. *Id.* art. 14.

205. Report of the Appellate Body, *Canada—Measures Affecting the Export of Civilian Aircraft*, ¶ 157, WT/DS70/AB/R (Aug. 2, 1999).

206. Report of the Appellate Body, *United States-Final Countervailing Duty Determination With Respect to Certain Softwood Lumber from Canada*, ¶ 90, WT/DS257/AB/R (Jan. 19, 2004).

door to the use of out-of-country prices as the benchmark for measuring the benefit of a subsidy.<sup>207</sup>

After the USDOC started applying countervailing duties to Chinese products in 2007, the USDOC moved swiftly to use out-of-country benchmarks to measure the magnitudes of several types of alleged Chinese subsidies: loan, input, and land use subsidies. In *Coated Free Sheet Paper from the People's Republic of China* in 2007, the USDOC investigated whether the Chinese producers of the subject merchandise received loans from Chinese policy banks and state-owned commercial banks (SOCBs) at below-market interest rates.<sup>208</sup> In evaluating whether the loans were at below-market rates and, if so, by how much, the USDOC refused to use the interest rates for loans made by private and foreign banks in China as the benchmark for market interest rates. This was because “[the Chinese government]’s intervention in the banking sector creates significant distortions, even restricting and influencing private and foreign banks within the PRC.”<sup>209</sup> The USDOC also rejected Chinese national interest rates as the benchmark by pointing to the “pervasiveness of the [Chinese government]’s intervention in the banking sector.”<sup>210</sup> Having rejected these in-country benchmarks, the USDOC constructed an out-of-country loan benchmark based on the interest rates of thirty-three lower- to middle-income countries considered comparable to China’s economic development level.<sup>211</sup> After *Coated Free Sheet Paper from the People's Republic of China*, the USDOC routinely used the same kind of out-of-country loan benchmarks in subsequent countervailing duty proceedings involving Chinese products.<sup>212</sup>

The USDOC also used out-of-country benchmarks to measure whether Chinese SOEs sold inputs to downstream producers at below-market prices. In *Circular Welded Carbon Quality Steel Pipe from the People's Republic of China*, for example, the USDOC found that 96.1% of the input in question, hot-rolled steel, was provided by SOEs.<sup>213</sup> The USDOC thus rejected Chinese domestic prices for hot-rolled steel as the market price benchmark because “where the Department finds that the government provides the majority, or a

---

207. For detailed discussions of the history of out-of-country benchmarks in countervailing duty law, see Wentong Zheng, *The Pitfalls of the (Perfect) Market Benchmark: The Case of Countervailing Duty Law*, 19 MINN. J. INT’L L. 1, 8-35 (2010).

208. See Issues and Decision Memorandum for the Final Determination in the Countervailing Duty Investigation of Coated Free Sheet Paper from the People’s Republic of China (Oct. 17, 2007), at 5, <http://enforcement.trade.gov/frn/summary/PRC/E7-21046-1.pdf> [hereinafter China CFS Paper I&D Memo].

209. *Id.* at 5.

210. *Id.* at 6.

211. *Id.* In constructing the out-of-country loan benchmark, the USDOC did not use the simple average of the interest rates of the comparable countries, but regressed the interest rates of the comparable countries on a World Bank governance index measuring the quality of each country’s institutions. See *id.*

212. See, e.g., CWP CVD I&D Memo, *supra* note 182, at 6-7; LWS CVD I&D Memo, *supra* note 182, at 82-83; OTR Tires CVD I&D Memo, *supra* note 182, at 7-9.

213. CWP CVD I&D Memo, *supra* note 182, at 11.

substantial portion of the market for a good or service, prices for such goods and services in the country will be considered significantly distorted and will not be an appropriate basis of comparison for determining whether there is a benefit.”<sup>214</sup> The USDOC then used the import prices the Chinese respondents paid to suppliers from outside of China or, when such import prices were not applicable, world market export prices, to determine if the Chinese SOEs provided a benefit to the downstream producers of the subject merchandise.<sup>215</sup>

The USDOC also applied the same out-of-country benchmark analysis to Chinese land use subsidies. In *Laminated Woven Sacks from the People's Republic of China*, the USDOC probed whether the Chinese government granted land-use rights to Chinese producers of the subject merchandise at below-market prices.<sup>216</sup> The USDOC rejected Chinese land prices as the market price benchmark because “Chinese land prices are distorted by the significant government role in the market.”<sup>217</sup> The USDOC then compared the prices for land use rights in China with certain land prices in Thailand, prices that the USDOC argued were “comparable market prices for land purchases in a country at a comparable level of economic development that is reasonably proximate to, but outside of, China.”<sup>218</sup>

China challenged the USDOC's use of out-of-country benchmarks for alleged Chinese input, loan, and land use subsidies before the WTO in two dispute settlement proceedings, DS379 and DS437. In DS379, China failed to persuade the panel and the Appellate Body that the USDOC acted inconsistently with WTO law in using such out-of-country benchmarks. As for input subsidies, the Appellate Body in DS379 interpreted its report in *Softwood Lumber* as “exclud[ing] the application of a per se rule, according to which an investigating authority could properly conclude in every case, and regardless of any other evidence, that the fact that the government is the predominant supplier means that private prices are distorted for the use of out-of-country benchmarks.”<sup>219</sup> The Appellate Body acknowledged that the USDOC's consideration of factors other than government market share in the underlying proceedings “appears to have been somewhat cursory.”<sup>220</sup> But since the Chinese government had a predominant 96.1% market share in the market in question, the Appellate Body considered the USDOC's rejection of in-country benchmarks to be justified because “evidence of factors other than government market share will have less weight in the determination of price distortion than in a situation where the government has only a ‘significant’ presence in the market.”<sup>221</sup> As for loan

---

214. *Id.* at 64.

215. *Id.* at 66.

216. See LWS CVD I&D Memo, *supra* note 182, at 14.

217. *Id.* at 15.

218. *Id.* at 17.

219. DS379 AB Report, *supra* note 164, ¶ 443.

220. *Id.* ¶ 454.

221. *Id.* ¶ 455.

subsidies, the Appellate Body held that its reasoning in *Softwood Lumber* concerning the use of out-of-country benchmarks was “equally applicable” in measuring the benefits of loan subsidies.<sup>222</sup> On this basis, the Appellate Body concluded that the USDOC’s decision not to rely on interest rates in China for Chinese loans was “reasoned and adequate.”<sup>223</sup> The Appellate Body found, however, that the panel below failed to make an objective assessment of whether the out-of-country benchmark constructed by the USDOC for Chinese loans was consistent with the requirement of Article 14(b) of the SCM Agreement.<sup>224</sup> As for land use subsidies, an issue not appealed by China to the Appellate Body, the panel in DS379 determined that the USDOC underwent sufficient analysis in rejecting Chinese land-use prices as the subsidy benchmark.<sup>225</sup> The panel further upheld the out-of-country benchmarks the USDOC constructed from Thailand prices, noting that although those out-of-country benchmarks were not a perfect representation of what land use prices would be in China in the absence of government distortions, it was not clear that adjusting the benchmarks in ways suggested by China “would ensure a closer approximation of the counterfactual situation.”<sup>226</sup>

In DS437, China pressed again on the use of out-of-country benchmarks for Chinese input subsidies, this time with success. The Appellate Body in DS437 found that the panel below “failed to conduct a case-by-case analysis of whether the USDOC had properly examined whether the relevant in-country prices were market determined or were distorted by governmental intervention.”<sup>227</sup> Instead, the panel “simply assumed that because the Appellate Body had faced a similar situation in [DS379], China had failed to establish that the USDOC acted inconsistently with the obligations of the United States under Article 14(d).”<sup>228</sup> After reversing the panel, the Appellate Body went on to complete the legal analysis and concluded that the USDOC acted inconsistently with Article 14(d) of the SCM Agreement by rejecting in-country prices in China as the subsidy benchmark.<sup>229</sup> According to the Appellate Body, the USDOC based its rejection of in-country prices in China on the fact that government-related entities were the predominant suppliers of the relevant goods.<sup>230</sup> The USDOC did not explain whether and how the government-related suppliers “possessed and exerted

---

222. *Id.* ¶ 489.

223. *Id.* ¶ 509.

224. *Id.* ¶ 527. But because of the lack of factual records before it, the Appellate Body was unable to make a judgment of its own on whether the USDOC’s out-of-country loan benchmark was sufficient. *See id.* ¶¶ 528-37.

225. DS379 Panel Report, *supra* note 160, ¶ 10.81.

226. *Id.* ¶ 10.189.

227. Report of the Appellate Body, United States—Countervailing Duty Measures on Certain Products from China, ¶ 4.79, WT/DS437/AB/R (Dec. 18, 2014) [hereinafter DS437 AB Report].

228. *Id.*

229. *Id.* ¶¶ 4.95-96.

230. *Id.* ¶ 4.95.

market power such that other in-country prices were distorted.”<sup>231</sup> “Nor did the USDOC explain whether the prices of the [government-related suppliers] themselves were market determined.”<sup>232</sup>

In sum, in a pattern that has become all too familiar, trade law has worked its way into a delicate balance regarding the use of out-of-country benchmarks for Chinese subsidies: It accepted such benchmarks when there was evidence of extensive market distortion by the Chinese government, but refused to infer market distortion simply from the Chinese government’s predominant presence in the market through SOEs. Investigating authorities would still be able to discard prices charged by Chinese SOEs as being distorted, but that would require a more rigorous market distortion analysis than simply pointing to the government ownership and control of those SOEs. This will pose a hurdle to efforts to use countervailing duty law as a protectionist tool against Chinese products.

### C. Safeguards

Aside from antidumping and countervailing duties, trade law also authorizes the imposition of so-called safeguard measures—measures that temporarily suspend a WTO member country’s tariff concessions or other WTO obligations in order to remedy serious injury to domestic industries caused by surges of imports from other WTO member countries.<sup>233</sup> However, this type of safeguard, referred to as the general safeguard below, was considered inadequate to deal with surges of imports from China. Upon China’s entry into the WTO, WTO member countries negotiated with China a special, temporary type of safeguard that allows them to specifically target imports from China under lowered evidentiary standards.<sup>234</sup> As will be discussed below, this “China safeguard” deviates from the WTO’s fundamental non-discrimination principle and is designed to channel protectionist pressures resulting from China’s WTO entry.

Unlike antidumping and countervailing duties, which do not facially single out China, the China safeguard is by design a trade remedy instrument with explicit, lopsided biases against Chinese products. First, the China safeguard allows WTO member countries to suspend their WTO obligations only towards China, in sharp contrast to the non-discrimination requirement under the general safeguard.<sup>235</sup> Second, the China safeguard can be invoked under a lower injury

---

231. *Id.* ¶ 4.96.

232. *Id.*

233. See GATT 1994, *supra* note 30, art. XIX:1(a); WTO Agreement on Safeguards, June 1, 1995, 1869 U.N.T.S. 154, art. 2.1 [hereinafter WTO Agreement on Safeguards].

234. China Accession Protocol, *supra* note 86, ¶ 16.

235. Article 2.2 of the WTO Agreement on Safeguards requires that a general safeguard be applied to imports regardless of source. See Agreement on Safeguards, arts. 2(2), in Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, 33 I.L.M. 1125 (1994).



standard than the general safeguard. Under the China Accession Protocol, WTO member countries can resort to the China safeguard when Chinese products are imported “in such increased quantities or under such conditions as to cause or threaten to cause market disruption to the domestic producers of like or directly competitive products.”<sup>236</sup> The term “market disruption” is further defined to refer to the situation where imports “are increasing rapidly, either absolutely or relatively, so as to be a significant cause of material injury, or threat of material injury to the domestic industry.”<sup>237</sup> This injury standard is generally understood to be easier to meet than the “serious injury” standard under the general safeguard.<sup>238</sup> Third, it is harder for China to seek trade compensations from countries that impose the China safeguard than for other countries to seek trade compensations from countries that impose the general safeguard. Under the general safeguard, a country whose products are subject to the safeguard is allowed to suspend substantially equivalent concessions to the trade of the country that imposes the safeguard,<sup>239</sup> subject to a three-year delay if the safeguard is based on an absolute increase in imports.<sup>240</sup> By contrast, under the China safeguard, China is entitled to no trade compensations for the first two years of a China safeguard even if the safeguard is based on a relative increase in imports.<sup>241</sup> Finally, the general safeguard may not be applied for more than

---

236. China Accession Protocol, *supra* note 86, ¶ 16.1.

237. *Id.* art. 16.4.

238. The “serious injury” standard under the general safeguard is defined in the WTO Agreement on Safeguards as “a significant overall impairment in the position of a domestic industry.” WTO Agreement on Safeguards, *supra* note 233, art. 4.1(a). The WTO Appellate Body has found that this standard is “exacting” and “very high” compared to the “material injury” standard contained in the WTO Antidumping Agreement, the SCM Agreement, and Article VI of the GATT. Report of the Appellate Body, United States—Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia, ¶ 124, WT/DS177/AB/R, WT/DS178/AB/R (May 1, 2001). By contrast, the “market disruption” standard under the China safeguard is understood to be a lower standard. A White House summary of the U.S.-China Bilateral WTO Agreement, the blueprint for the China Accession Protocol, stated that under the China safeguard, the United States would be able to apply restraints unilaterally based on standards that are lower than those in the WTO Safeguards Agreement.” Summary of the U.S.-China Bilateral WTO Agreement, Prepared by the White House National Economic Council, November 15, 1999, 16 Int’l Trade Rep. (BNA) 1888, 1890 (1999). In a congressional testimony, then U.S. Trade Representative Charlene Barshefsky stated that the China safeguard “permits us to act based on lower showing of injury.” Accession of China to the WTO; Hearing Before the House Comm. on Ways and Means, 106th Cong. 49 (2000) (Statement of Hon. Charlene Barshefsky, United States Trade Representative). For more discussions of the injury standard under the general safeguard and the China safeguard, see Jeanne J. Grimmett, *Chinese Tire Imports: Section 421 Safeguards and the World Trade Organization (WTO)*, CONG. RES. SERV. (Jul. 12, 2011), at 7-9; Jing Ma, *Product-Specific Safeguard in China’s WTO Accession Agreement: An Analysis of Its Terms and Its Initial Application in Section 421 Investigations*, 22 BU INT’L L.J. 189, 195-197 (2004).

239. See WTO Agreement on Safeguards, *supra* note 233, art. 8.2.

240. *Id.* art. 8.3.

241. China Accession Protocol, *supra* note 86, ¶ 16.6 (“If a measure is taken as a result of a relative increase in the level of imports, China has the right to suspend the application of substantially equivalent concessions or obligations under the GATT 1994 to the trade of the WTO Member applying the measure, if such measure remains in effect more than two years.”).

four years initially and eight years in total.<sup>242</sup> By contrast, the only requirement for the duration of the China safeguard is that the China safeguard is to be imposed “only for such period of time as may be necessary to prevent or remedy the market disruption.”<sup>243</sup>

With these institutional biases against China on the China safeguard, the WTO Appellate Body has restrained itself from disturbing the outcome of China's WTO entry negotiations. In one WTO dispute settlement proceeding, DS399, China challenged a safeguard measure applied by the United States to imports of certain passenger vehicle and light truck tires from China.<sup>244</sup> The Appellate Body in DS399 took a very flexible approach to the interpretation of the phrase “increasing rapidly” in Paragraph 16.4 of the China Accession Protocol, granting investigating authorities sufficient leeway in determining whether the requisite “market disruption” exists for the invocation of the China safeguard.<sup>245</sup> The Appellate Body then evaluated to what extent the injury to the importing country's domestic industry must be caused by rapidly increasing imports from China before the China safeguard could be triggered.<sup>246</sup>

Paragraph 16.4 of the China Accession Protocol provides that for there to be market disruption, imports from China must be increasing rapidly so as to be “a significant cause” of material injury, or threat of material injury, to the importing country's domestic industry.<sup>247</sup> The Appellate Body interpreted that language to mean that rapidly increasing imports from China “may be one of several causes that contribute to producing or bringing about material injury to the domestic industry.”<sup>248</sup> The Appellate Body added that while “the contribution made by rapidly increasing imports to the material injury of the

---

242. WTO Agreement on Safeguards, *supra* note 233, art. 7.1, 7.3.

243. China Accession Protocol, *supra* note 86, ¶ 16.6. Note, however, that China is entitled to suspend substantially equivalent concessions to the trade of the country imposing the China safeguard if the safeguard is still in effect after two years where the safeguard was based on a relative increase in imports, or after three years where the safeguard was based on an absolute increase in imports. *See id.*

244. *See* Request for Consultation by China, United States—Measures Affecting Imports of Certain Passenger Vehicle and Light Truck Tyres from China, WT/DS399/1 (Sept. 16, 2009), at 1.

245. *See* Report of the Appellate Body, United States—Measures Affecting Imports of Certain Passenger Vehicle and Light Truck Tyres from China, ¶¶ 126-170, WT/DS399/AB/R (Sept. 5, 2011) [hereinafter DS399 AB Report]. Specifically, the Appellate Body held that the “increasing rapidly” phrase did not require an investigating authority to “focus on the movements in imports during the most recent past, or during the period immediately preceding the authority's decision.” *Id.* ¶ 149. The Appellate Body also found that the ordinary meaning of the term “rapidly” did not suggest “an exclusive focus on the rates of increase in subject imports.” *Id.* ¶ 158. Particularly, the Appellate Body held that a decline in the yearly rate of increase did not necessarily preclude a finding that imports are increasing rapidly. *Id.* ¶ 162. Finally, the Appellate Body held that the phrase “increasing rapidly” did not require an investigating authority to assess the most recent rate of increase in subject imports relative to the rates of increase in earlier periods. *Id.* ¶ 167.

246. *Id.* ¶¶ 171-338.

247. China Accession Protocol, *supra* note 86, ¶ 16.4.

248. DS399 AB Report, *supra* note 245, ¶ 177.

domestic industry must be important or notable,”<sup>249</sup> the inclusion of the term “significant” to qualify “a cause” does not impose “a more rigorous causation standard than other WTO agreements, which require that imports ‘cause’ injury.”<sup>250</sup> In so holding, the Appellate Body essentially read the word “significant” out of the injury standard for the China safeguard. Furthermore, in what appeared to be an insinuation that China itself negotiated a lower injury standard for the China safeguard as part of its WTO entry deal, the Appellate Body stated that the object and purpose of the China Accession Protocol “seems to weigh in favour of an interpretation pursuant to which temporary relief is available whenever rapidly increasing imports are making an ‘important’, rather than a ‘particularly strong [and] substantial’, contribution to the material injury of the domestic industry.”<sup>251</sup> Based on this low injury standard, the Appellate Body finally held that the United States International Trade Commission did not err in concluding that rapidly increasing imports from China were a significant cause of material injury to the domestic industry within the meaning of Paragraph 16.4 of the China Accession Protocol.<sup>252</sup>

The China safeguard epitomizes the perpetual dilemma facing trade law: On one hand, trade law needs to adhere to principles to maintain a rule-based trade system, but on the other hand, trade law needs sufficient flexibility to accommodate and contain disruptive forces like China. The China safeguard solves this dilemma by compromising on principles, but only for a limited period of time. Pursuant to Paragraph 16.9 of the China Accession Protocol, the duration of the China safeguard is limited to twelve years from China’s WTO entry.<sup>253</sup> The China safeguard, therefore, expired on December 11, 2013. With this temporary deviation from principles, trade law afforded the world trade community greater abilities to withstand the impact from liberalizing trade with China.

#### *D. Managed Trade*

One important feature of trade law’s responses to China’s rise in world trade is its tolerance of the frequent uses of managed trade measures – namely, restrictive trade measures imposed through voluntary agreements, for Chinese products. As will be discussed below, one guiding principle of trade law is to discourage the use of managed trade measures, but when it comes to China, managed trade has played an important role in easing the tensions stemming from China’s participation in the world trade order.

Managed trade was once a mainstay in world trade. Between 1974 and 2005, world trade in textiles and apparel products was governed by an exquisite

---

249. *Id.*

250. *Id.* ¶ 181. The Appellate Body believed that the term “cause” in other WTO agreements also required a “genuine and substantial relationship of cause and effect.” *Id.*

251. *Id.* ¶ 184.

252. *Id.* ¶ 338.

253. China Accession Protocol, *supra* note 86, ¶ 16.9.

managed-trade system established under the Multi-Fiber Arrangement (MFA),<sup>254</sup> which allowed “a complex system of unilateral and bilateral quotas, on a product-by-product and country-by-country basis.”<sup>255</sup> In the 1970s and 1980s, GATT member countries frequently resorted to the so-called voluntary export restraints (VERs), that is, negotiated export arrangements outside the rubric of GATT rights and obligations, as a way of resolving trade disputes.<sup>256</sup> VERs gained increasing popularity with countries seeking to protect their domestic industries<sup>257</sup> and became “arguably the most pernicious form of protection in the 1970s and 1980s.”<sup>258</sup>

Managed-trade measures like VERs have been widely criticized as operating in a gray area outside of the GATT framework and undermining the integrity of the multilateral trade system.<sup>259</sup> The adverse economic impact of managed trade has also been well-documented.<sup>260</sup> But nonetheless, managed trade became a popular trade policy tool because it was a politically attractive form of protection.<sup>261</sup> In particular, all of the parties involved in a managed-trade regime, including the importing country, the exporting country, and third countries, lack sufficient incentives to object to its use.<sup>262</sup>

---

254. See Multi-Fiber Arrangement, Formerly the Arrangement Regarding International Trade in Textiles, 25 UST 1001, TIAS No 7840 (Dec 20, 1973).

255. Alice J.-H. Wohn, *Towards GATT Integration: Circumventing Quantitative Restrictions on Textiles and Apparel Trade under the Multi Fiber Arrangement*, 22 U. PA. J. INT'L ECON. L. 375, 395 (2001).

256. Many of such VERs were targeted at Japan, whose surging exports at the time were flooding the world market. In the 1970s and the 1980s, a number of Japanese products, including color television sets, motor vehicles, video tape recorders, motor cycles, machine tools, quartz watches, and fork-lift trucks were made subject to voluntary export arrangements negotiated between the United States, Europe, and Canada on one hand and Japan on the other hand. See Philip Turner & Jean-Pierre Tuveri, *Some Effects of Export Restraints on Japanese Trading Behavior*, OECD ECON. STUD., Spring 1984, 93, 94-95.

257. As of 1991, only twenty four safeguard measures taken pursuant to Article XIX of the GATT were in force, while two hundred and eighty four gray-area measures such as VERs were known to exist. Terence P. Stewart et al., *Opportunities in the WTO for Increased Liberalization of Goods: Making Sure the Rules Work for All and That Special Needs Are Addressed*, 24 FORDHAM INT'L L.J. 652, 657 (2000).

258. Jeffrey J. Schott, *Safeguards*, in THE NEW WORLD TRADING SYSTEM: READINGS 113, 114 (Organisation for Economic Co-Operation and Development ed., 1994).

259. See, e.g., JAGDISH BHAGWATI, PROTECTIONISM 47 (1988); ALAN O. SYKES, THE WTO AGREEMENT ON SAFEGUARDS: A COMMENTARY 24-25 (2006).

260. See, e.g., Jaime de Melo & L. Alan Winters, *Do Exporters Gain from VERs?*, 37 EUR. ECON. REV. 1331 (1993) (arguing that VERs cause efficiency losses to importing countries by inducing inputs to shift from their most efficient industries to protected industries); Phedon Nicolaides, *Safeguards and the Problem of VERs*, INTERECONOMICS, January/February 1990, 18, 21-22 (arguing that VERs encourage collusion among producers in the exporting country).

261. Nicolaides, *supra* note 260, at 20.

262. *Id.* The affected exporting country tolerates managed trade because it would enable the exporting country to charge higher prices. The importing country prefers managed trade because unlike tariffs, quantitative restrictions under managed trade prevent foreign producers from increasing their market share as their efficiency improves. Third countries rarely object to managed trade because it handicaps their most efficient competitors. *Id.*

In the Uruguay Round negotiations, the GATT sought a collective solution to the managed trade problem and undertook an ambitious task of reining in the use of managed-trade measures like the VERs. As a result of the Uruguay Round, the Agreement on Textiles and Clothing (ATC) was signed as one of the basic legal texts of the newly established WTO.<sup>263</sup> The ATC terminated the managed trade system for the textiles and clothing sector with a ten-year phase-out period.<sup>264</sup> During the phase-out period, quotas for textiles and clothing products were progressively reduced until they were completely eliminated on January 1, 2005.<sup>265</sup> As for VERs, the WTO Agreement on Safeguards provides that WTO member countries “shall not seek, take or maintain any voluntary export restraints, orderly marketing agreements or other similar measures on the export or the import side.”<sup>266</sup> The prohibited actions include “actions taken by a single Member as well as actions under agreements, arrangements and understandings entered into by two or more Members.”<sup>267</sup>

China’s WTO entry in 2001, however, posed a problem for the WTO’s efforts to scale back managed trade. The sheer size of China’s economy demanded flexibility in dealing with China’s potential impact on world trade, and, aside from creative applications of antidumping and countervailing duty laws, trade law resorted to managed trade as a way of providing that flexibility.

Trade law’s turn to managed trade can be seen in the way it accommodated China in the textiles and clothing sector. China joined the WTO in 2001, three years before the quota system established under the MFA was scheduled to be dismantled.<sup>268</sup> To protect importing countries from the short-term shock that China would be causing to the textiles and clothing markets in a quota-less world,<sup>269</sup> the WTO created a special safeguard mechanism just for textiles and clothing products from China for the first three years after the expiration of the ATC. Paragraph 242 of the Working Party Report on China’s Accession allows

---

263. Agreement on Textiles and Clothing, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, Multilateral Agreements on Trade in Goods—Results of the Uruguay Round, 33 I.L.M. 28, [http://www.wto.org/english/docs-e/legal\\_e/16-tex.pdf](http://www.wto.org/english/docs-e/legal_e/16-tex.pdf).

264. *Id.* art. 9 (“This Agreement and all restrictions thereunder shall stand terminated on the first day of the 121st month that the WTO Agreement is in effect, on which date the textiles and clothing sector shall be fully integrated into GATT 1994. There shall be no extension of this Agreement.”).

265. *Id.* art. 2.6-2.7.

266. WTO Agreement on Safeguards, *supra* note 233, art. 11.1(b). In a footnote, Article 11.1(b) of the WTO Agreement on Safeguards provides that “examples of similar measures include export moderation, export-price or import-price monitoring systems, export or import surveillance, compulsory import cartels and discretionary export or import licensing schemes, any of which afford protection.” *Id.* art. 11.1(b) n.4.

267. *Id.* art. 11.1(b).

268. As noted above, the ATC was scheduled to terminate on January 1, 2005. *See supra* note 264 and accompanying text.

269. Between 2001 and 2004, China’s exports of textiles and clothing products to the United States more than doubled, increasing from about \$7 billion to about \$15 billion. UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, U.S.-CHINA TRADE: TEXTILE SAFEGUARD PROCEDURES SHOULD BE IMPROVED (April 2005), at 1.

WTO member countries to place limits on imports of textiles and clothing products from China through the end of 2008 if such imports “were, due to market disruption, threatening to impede the orderly development of trade in these products.”<sup>270</sup>

Both the European Union and the United States took advantage of the special China textiles safeguard. In April 2005, the European Commission launched safeguard investigations into the sharp surge in imports of Chinese textiles and clothing products to the European Union.<sup>271</sup> On June 10, 2005, the European Union and China reached an agreement to terminate the pending safeguard investigations and to manage the growth of Chinese imports to the EU.<sup>272</sup> In a quintessential managed-trade deal, the EU and China agreed to limit growth in ten categories of Chinese imports to between 8 percent and 12.5 percent per year for 2005, 2006, and 2007.<sup>273</sup> In the United States, twice in 2003 and again in 2004, U.S. producers petitioned the U.S. government for safeguard quotas on imports of textiles and clothing products from China.<sup>274</sup> The U.S. government granted all three petitions and imposed quotas on ten categories of textiles and clothing products imported from China.<sup>275</sup> On November 6, 2005, the United States and China signed a memorandum of understanding that replaced those quotas and additional pending safeguard investigations with a managed-trade system covering most categories of textiles and clothing products for 2006, 2007, and 2008.<sup>276</sup> The U.S.-China MOU capped the rate of increase of imports of textiles products from China to the U.S. to 12.5 percent in 2006 and 2007, and 15 percent in 2008.<sup>277</sup> For imports of clothing products from China to the U.S., the maximum rate of increase was 10 percent in 2006, 12.5 percent in 2007, and 15 percent in 2008.<sup>278</sup>

Aside from authorizing managed trade for Chinese textiles and clothing products, trade law has also tolerated the use of managed trade for Chinese products for which it has not been explicitly authorized. In July 2013, the European Commission reached a price undertaking agreement with Chinese solar panel exporters to settle pending antidumping investigations into Chinese

---

270. Report of the Working Party on the Accession of China, WT/MIN01(3) (Nov. 10, 2001), ¶ 242.

271. Press Release, European Commission launches investigations into sharp surge in Chinese textiles imports, IP/05/473 (Apr. 24, 2005), [http://europa.eu/rapid/press-release\\_IP-05-473\\_en.htm](http://europa.eu/rapid/press-release_IP-05-473_en.htm).

272. See Press Release, EU-China textiles agreement 10 June 2005, MEMO/05/201 (Jun. 12, 2005), [http://europa.eu/rapid/press-release\\_MEMO-05-201\\_en.htm?locale=en](http://europa.eu/rapid/press-release_MEMO-05-201_en.htm?locale=en).

273. *Id.*

274. Michael F. Martin, U.S. Clothing and Textile Trade With China and the World: Trends Since the End of Quotas, CRS Report for Congress (Jul. 10, 2007), at 23.

275. *Id.*

276. See Memorandum of Understanding Between the Governments of the United States of America and the People's Republic of China Concerning Trade in Textile and Apparel Products (Nov. 6, 2005), [http://otexa.trade.gov/PDFs/US-China\\_Textile\\_MOU.pdf](http://otexa.trade.gov/PDFs/US-China_Textile_MOU.pdf).

277. Martin, *supra* note 274, at 24.

278. *Id.*

solar panel products sold in the European Union.<sup>279</sup> The price undertaking agreement replaced provisional antidumping duties imposed on imports of Chinese solar panel products to the EU with a minimum price commitment that capped the price of the Chinese imports at fifty-six euro cents per watt.<sup>280</sup> The agreement did not exempt Chinese solar panel imports from antidumping duties when such imports exceeded seven gigawatts, roughly half of the EU's demand for solar panels.<sup>281</sup> The price undertaking agreement, therefore, functioned as a tacit permission for Chinese producers to supply half of the EU's solar panel market. Although this attempt at managing solar panel trade between the EU and China does not technically violate WTO rules,<sup>282</sup> it goes against the spirit of the WTO's prohibition of VERs in every practical sense.<sup>283</sup>

In sum, despite trade law's earlier efforts to limit the use of managed trade, it had to turn to the device as a way of mitigating the impact of China on the world trade order. Again, between principles and protectionism, trade law had to favor the latter, albeit temporarily and tacitly, to accommodate the disruptive forces that China would have otherwise unleashed onto the world trade system.

### III.

#### TRADE LAW'S REBALANCING: SUCCESS OR FAILURE?

The foregoing discussions tell a story of how China disrupted trade law's balance. As trade law deviates from its previous principles-versus-protectionism equilibrium, a crucial question to ask is whether trade law will be able to stabilize in a new equilibrium where China's role in world trade is taken into account.

Unfortunately, this question cannot be fully answered before China's role itself is stabilized. Will China continue on the path of expansion it has been on

---

279. European Commission Press Release, Commissioner De Gucht: "We found an amicable solution in the EU-China solar panels case that will lead to a new market equilibrium at sustainable prices" (Jul. 27, 2013), [http://europa.eu/rapid/press-release\\_MEMO-13-729\\_en.htm](http://europa.eu/rapid/press-release_MEMO-13-729_en.htm).

280. Robin Emmott & Ben Blanchard, *EU, China resolve solar dispute - their biggest trade row by far*, REUTERS (Jul. 27, 2013), <http://www.reuters.com/article/2013/07/27/us-eu-china-solar-idUSBRE96Q03Z20130727>.

281. *Id.*

282. The WTO Antidumping Agreement allows WTO member countries to suspend or terminate antidumping proceedings "upon receipt of satisfactory voluntary undertakings from any exporter to revise its prices or to cease exports to the area in question at dumped prices so that the authorities are satisfied that the injurious effect of the dumping is eliminated." WTO Antidumping Agreement, *supra* note 33, art. 8.1.

283. Michael Moore demonstrates that in a perfectly-competitive small-country model, a maximum level of imports under a VER and a minimum import price undertaking can result in identically higher prices, lower imports, increased domestic profits, and higher domestic production compared to free trade. See Michael O. Moore, *VERs and Price Undertakings under the WTO*, 13 REV. INT'L ECON. 298, 298 (2005). Moore further demonstrates that in the context of a domestic monopoly facing foreign competition, a minimum price undertaking can result in even lower consumer welfare than under a quantity-based VER. *Id.* at 298-99.

in the last three decades?<sup>284</sup> Or will China plateau and be integrated into a steady world trade system?<sup>285</sup> Or will China's export growth collapse and force the legal structures that trade law put in place in response to China's rise to unravel?<sup>286</sup> Without knowing which development trajectory China will follow, it is premature to predict whether or when trade law's rebalancing act on China will be complete.

That said, a preliminary assessment of trade law's responses to China's rise *so far* could yield valuable policy implications. This assessment has to be done in light of the ultimate goals trade law is supposed to serve. Given the two competing considerations of trade law—free trade principles and protectionism—an objective evaluation of whether trade law has by far successfully handled challenges posed by China requires the assessor to approach the task from a holistic point of view, taking into account both considerations. Under this holistic approach, the criterion for judging the success or failure of trade law's rebalancing in response to China has to be whether trade law was able to offer protection from China's impact without deviating too much from its core principles.

Based on the analyses in the previous section, this Article's answer to the question of whether trade law has by far succeeded in accommodating China is a cautious "yes." On one hand, trade law's record on China is not perfect: on many occasions it has shifted, blatantly or subtly, to a less principle-oriented approach in contravention of the fundamental principles cherished by trade law elsewhere. Trade law sanctioned the use of surrogate values in antidumping proceedings in a manner that gives importing countries wide discretion to inflate antidumping margins for Chinese products. Trade law considered China's economy to be market-based enough to apply countervailing duty law, but not market-based enough to warrant market-economy treatment in antidumping proceedings. Trade law also fashioned a discriminatory China-specific safeguard and tolerated the use of managed trade that it had vowed to eliminate in other settings for Chinese products.<sup>287</sup> All of these represent a shift towards protectionism at the expense of sound, consistent principles.

But on the other hand, trade law has corrected itself on some of the most egregious protectionist policies on China. Trade law rejected the presumption of

---

284. Proponents of this scenario predict that China's economy will soon surpass that of the United States to become the world's largest. See *Chinese and American GDP Forecasts: Catching the Eagle*, *ECONOMIST* (Aug. 22, 2014), <http://www.economist.com/blogs/graphicdetail/2014/08/chinese-and-american-gdp-forecasts>.

285. Official economic data coming out of China suggests that China's GDP growth has slowed in recent years but is not showing further signs of deceleration. In the first two quarters of 2015, China maintained an enviable growth rate of seven percent. See Mark Magnier, *China Surprises With 7% Growth in Second Quarter*, *WALL ST. J.* (Jul. 21, 2015), <http://www.wsj.com/articles/china-surprises-with-7-growth-in-second-quarter-1436927081>.

286. This scenario is likely if China's economic growth stalls. For a pessimistic view of the prospect of China's economy, see Paul Krugman, *Hitting China's Wall*, *N.Y. TIMES* (Jul. 18, 2013), [http://www.nytimes.com/2013/07/19/opinion/krugman-hitting-chinas-wall.html?\\_r=0](http://www.nytimes.com/2013/07/19/opinion/krugman-hitting-chinas-wall.html?_r=0).

287. See *supra* Part II.



country-wide antidumping duty rates for Chinese products, forced investigating authorities to not double-count certain types of Chinese subsidies when applying countervailing duty law in conjunction with antidumping law, declined to automatically treat Chinese SOEs as public bodies capable of conferring subsidies, and refused to infer price distortion merely from government dominance in the market. These decisions demonstrate trade law's commitments to principles even in the face of high protectionist pressures.

Trade law's responses to China have been rather successful especially compared to its responses to the previous disruptor of the world trade system—Japan. Between the 1950s and the 1980s, when Japan was upending the existing world trade order, the world trade community responded primarily with bilateral negotiations, retaliations, and threats of retaliations.<sup>288</sup> In particular, in one of the most infamous trade wars in world trade history, the United States reached a managed-trade agreement with Japan on trade in semiconductor products and, after Japan allegedly violated the agreement, imposed retaliatory tariffs on imports from Japan.<sup>289</sup> By contrast, the world trade community managed to avoid such disruptive spikes in tariffs against Chinese products, despite its many maneuvers not entirely consistent with trade law principles. More importantly, the world trade community managed to incorporate China into the world trade system without major political, economic, and social upheavals. As an indication of that incorporation, China has become one of the countries that most frequently make use of the WTO dispute settlement mechanism.<sup>290</sup>

The interactive dynamics between free trade principles and protectionism identified in this Article have important policy implications. First of all, they hold predicative values for the future trajectory of trade law as applied to China. One important insight from this Article is that trade law is never an outcome of principles alone, or protectionism alone. Interpretations of trade law—and predictions of what those interpretations will be—have to be made in light of both. The ongoing debates on China's market-economy status after December 2016 provides a perfect example. As discussed above, Paragraph 15(a)(ii) of the China Accession Protocol, which provides for the use of surrogate values in antidumping proceedings involving Chinese products, expires in December 2016.<sup>291</sup> Views diverge, however, as to whether China should be granted market-economy status automatically upon the expiration of Article 15(a)(ii), or whether WTO member countries should be allowed to continue to treat China as a non-market economy if China does not meet their standards for being considered a market economy. In February 2016, the European Union launched

---

288. See John O. Haley, *Luck, Law, Culture and Trade: The Intractability of United States-Japan Trade Conflict*, 22 CORNELL INT'L L.J. 403, 413-16 (1989) (discussing trade disputes between the United States and Japan between the 1950s and the 1980s).

289. See JOHN M. ROTHGEB, JR., U.S. TRADE POLICY: BALANCING ECONOMIC DREAMS AND POLITICAL REALITIES 189-190 (2001).

290. In 2009 alone, China was a party to half of the fourteen new WTO dispute settlement proceedings initiated in that year. Ji & Huang, *supra* note 9, at 2.

291. See *supra* note 88 and accompanying text.

public consultation on how to proceed on China's market-economy status.<sup>292</sup> Options being considered by the EU included automatic market-economy status for China either with or without strengthened trade remedy rules in other respects.<sup>293</sup> The United States, however, appears reluctant to consider the possibility of automatically granting China market-economy status.<sup>294</sup> While a full examination of this issue is beyond the scope of this Article, the analysis set forth in this Article suggests that the eventual outcome of this issue will not depend on legal analysis alone.<sup>295</sup> Instead, it will depend in large part on commercial circumstances.<sup>296</sup> If the threat from Chinese exports is perceived to be waning, and if China is showing willingness to allay trading partners' concerns in other aspects of trade policy such as currency manipulation, it will be much easier for China's trading partners to come to the conclusion that the expiration of Article 15(a)(ii) mandates market-economy status for China.<sup>297</sup> In other words, decisions on China's market-economy status are inherently policy decisions, particularly so when the legal analysis does not provide unambiguous answers.

Finally, the principles-versus-protectionism dynamics identified in this Article will also likely determine trade law's responses to the next challenger to the world trade system. If the next challenger threatens the stability of the world trade system like China does, trade law will likely show flexibilities on principles to contain the challenger. The specific issues on which trade law will show flexibilities, however, may not be the same as those featured in trade law's China responses. Particularly, if the next challenger is generally considered a

---

292. See Public online consultation concerning a possible change in the methodology to establish dumping in trade defence investigations concerning the People's Republic of China, EUR. COMMISSION, [http://trade.ec.europa.eu/consultations/index.cfm?consul\\_id=191](http://trade.ec.europa.eu/consultations/index.cfm?consul_id=191) (last updated Aug. 1, 2016).

293. See Memorandum from Leopoldo Rubinacci on China Market-Economy Status (Feb. 2, 2016), <http://www.politico.eu/wp-content/uploads/2016/02/160202ChinaMESpaper.pdf> [hereinafter EU Memo on China Market-Economy Status].

294. It was reported that Deputy United States Trade Representative Michael Punke was of the view that China's graduation from non-market economy should not be automatic with the change of a date. See Bryce Baschuck, *U.S., China at Logheads Over Market Economy Status*, BLOOMBERG BNA WTO REPORTER (Mar. 11, 2016).

295. It is not helpful that Paragraph 15 of the China Accession Protocol has enough ambiguities to allow it to be interpreted in different ways. For arguments that Paragraph 15 does not require automatic market-economy status for China after December 2016, see Alan H. Price, Written Statement Before the U.S.-China Economic and Security Review Commission (Feb. 24, 2016), [http://www.uscc.gov/sites/default/files/Panel%204\\_Price%20statement\\_022416.pdf](http://www.uscc.gov/sites/default/files/Panel%204_Price%20statement_022416.pdf).

296. One of the most important factors in the debates on this issue is the economic impact of the change in antidumping methodology. For example, as the EU considers granting market-economy status to China, its top concern appears to be losses of jobs within the EU in response to lower antidumping rates for Chinese products. See EU Memo on China Market-Economy Status, *supra* note 293, at 4-6.

297. Gary Hufbauer of the Peterson Institute for International Economics holds the same view. See Gary Clyde Hufbauer, Testimony Before the U.S.-China Economic and Security Review Commission on China's Shifting Economic Realities and Implications for the United States, at 3, [http://www.uscc.gov/sites/default/files/Panel%204\\_Hufbauer%20statement\\_022416.pdf](http://www.uscc.gov/sites/default/files/Panel%204_Hufbauer%20statement_022416.pdf).

market-economy country, the next rounds of trade law debates may not revolve around issues that are peculiar to non-market economies, such as surrogate values and country-wide rates in antidumping. What is certain, however, is that trade law will tolerate deviations from principles on *some* issues and those deviations will allow trade law to adjust the level of trade protection commiserate with the level of threats posed by the challenger.

#### CONCLUSION

World trade has undergone a sea change since China began its ascent in the global economic order. So has trade law. In almost all major areas of trade law, there has been a shift towards protectionism at the expense of principles. But on some of the most important trade policy issues relating to China, trade law has overcome the urge to become a purely protectionist exercise. These nuanced responses to China reveal the protean nature of trade law and offer guidance as to how trade law will likely handle future disruptors of the world trade system.

# The Evolution of Investor-State Arbitration in the Trans-Pacific Partnership Agreement

Alexander W. Resar\*

## TABLE OF CONTENTS

I. INTRODUCTION: INVESTMENT IN THE TPP .....	159
II. NEW PROVISIONS AND MODIFICATIONS IN THE TPP .....	164
A. <i>Changes Reducing Investor Protections</i> .....	166
1. <i>Like Circumstances and Governmental Regulation</i> .....	166
2. <i>Investor Expectations</i> .....	170
3. <i>Minimum Standard of Treatment</i> .....	175
B. CHANGES FORECLOSING PARTICULAR CLAIMS AND CLAIMANT STRATEGIES .....	179
1. <i>Maffezini and Procedural Cherry-Picking</i> .....	179
2. <i>Subsidy Schemes and Breaches of Investor Protection</i> .....	181
3. <i>Investment Authorization and Precluded Claims</i> .....	183
4. <i>Counterclaims</i> .....	184
III. CONTINUITY IN U.S.-NEGOTIATED INVESTMENT AGREEMENTS .....	186
A. <i>Overview</i> .....	186
B. <i>Expanded Investor Protections</i> .....	188
CONCLUSION .....	188

## I.

### INTRODUCTION: INVESTMENT IN THE TPP

After years of negotiation, the twelve Pacific Rim nations negotiating the Trans-Pacific Partnership (“TPP”) agreement reached a final accord on October 5<sup>th</sup>, 2015.<sup>1</sup> One month later, on November 5, 2015, the negotiating parties

---

DOI: <http://dx.doi.org/10.15779/Z38485H>

\* J.D., the Yale Law School (expected May 2017). Special thanks to Professor W. Michael Reisman and Professor Guillermo Aguilar-Alvarez for their feedback on earlier versions of this Note.

1. Andrew Rosenthal, *Trans-Pacific Partnership Is Reached, but Faces Scrutiny in*

simultaneously released the text of the TPP, and President Obama notified Congress of his intent to sign.<sup>2</sup> If ratified by all the negotiating parties, the TPP would be the largest regional trade accord in history, covering roughly forty percent of the global economy by binding together the United States, Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam, with the potential to incorporate additional states should the original members approve of any additions.<sup>3</sup> Across thirty chapters, the TPP agreement phases out thousands of import tariffs, establishes uniform intellectual property rules, enforces standards for labor conditions and environmental protection, and, among other provisions, regulates both the state treatment of foreign direct investment and the arbitration of disputes arising therefrom.<sup>4</sup>

One of the most significant criticisms of the TPP concerns the investor-state arbitration mechanism that the TPP's investment chapter retains from the North American Free Trade Agreement ("NAFTA"), the Dominican Republic-Central American Free Trade Agreement ("CAFTA"), and many of the United States' bilateral investment treaties ("BITs").<sup>5</sup> Despite the widespread criticism of investor-state arbitration in domestic political discourse and opposition from certain negotiating partners, the U.S. has successfully argued for the inclusion of an investor-state arbitration mechanism in all but one post-NAFTA free trade agreement and investment treaty.<sup>6</sup> The TPP maintains this feature of U.S.-

---

Congress, N.Y. TIMES, October 5, 2015,

<http://www.nytimes.com/2015/10/06/business/trans-pacific-partnership-trade-deal-is-reached.html>.

2. IAN F. FERGUSON, MARK A. MCMINIMY, BROCK R. WILLIAMS, CONG. RESEARCH SERV., R44278 THE TRANS-PACIFIC PARTNERSHIP (TPP): IN BRIEF (2015).

3. IAN F. FERGUSON, MARK A. MCMINIMY, BROCK R. WILLIAMS, CONG. RESEARCH SERV., R42694 THE TRANS-PACIFIC PARTNERSHIP (TPP) NEGOTIATIONS AND ISSUES FOR CONGRESS (2015).

4. *Id.* at i.

5. *Id.* at 36-37; see also, Elizabeth Warren, *The Trans-Pacific Partnership Clause Everyone Should Oppose*, WASH. POST, February 25, 2015.

6. United States-Australia Free Trade Agreement, U.S.-Austl., art. 11.16, May 18, 2004, 43 I.L.M. 1248, <https://ustr.gov/trade-agreements/free-trade-agreements/australian-fta/final-text>. But, even in the United States-Australia Free Trade Agreement, "the U.S. continued to press hard for the inclusion of investor-state dispute provisions [in the final round of negotiations in Washington in January 2004]. Australia expressed its equally strong opposition, on the grounds that their inclusion would be 'unacceptable' (confidential interview 2004). Ultimately, however, the U.S. backed down, and agreed to the Australian proposal that the legal systems in both countries were 'robust' enough to ensure that investors should find sufficient protection through domestic courts." A. Capling & K. R. Nossal, *Blowback: Investor-State Dispute Mechanisms in International Trade Agreements*, 19 GOVERNANCE 151, 160 (2006). Despite Australia's intense objection to investor-state arbitration in the bilateral free trade agreement, US investors can now bring claims against Australia under the TPP. Compare, Julian Assange, Secret Trans-Pacific Partnership Agreement (TPP) – Investment Chapter, note 29, WikiLeaks (March 25, 2015), <https://wikileaks.org/tpp-investment/> (hereinafter "WikiLeaks Investment Chapter") with Trans-Pacific Partnership Agreement, art. 9, Nov. 5, 2015, <https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text> (hereinafter "TPP"). The WikiLeaks Investment Chapter exempted Australia from provisions governing the settlement of investor-state disputes, while the investment chapter in the finalized TPP contains no such exemptions.

negotiated agreements covering investment and contains additional provisions related to nondiscriminatory treatment of foreign investment, the minimum standard of treatment owed foreign investors, standards for expropriation, prohibitions on performance requirements, and, of course, procedures for investor-state arbitration.<sup>7</sup>

Commentators, however, accurately note that the parties negotiating international investment agreements have adopted an increasingly state-friendly perspective.<sup>8</sup> As historically capital-exporting nations have become capital importers, these states developed an awareness of the threat investor-state arbitration poses to states under agreements that include other developed parties.<sup>9</sup> The historically capital-exporting states, and the U.S. in particular, are still the strongest proponents of investor-state arbitration in investment agreements. However, the breakdown of the dichotomy between capital-exporting and capital-importing states has left the traditional capital-exporters increasingly wary of subjecting their own regulations, judicial decisions, and governmental actions to international arbitral tribunals.<sup>10</sup> This development in capital-exporters' concerns has not destroyed the arbitration mechanism in international investment agreements, with Australia as the notable exception, and even they eventually acceded to the TPP's investment chapter.<sup>11</sup> Instead, this development led states to include additional restrictions on the rights and remedies available to investors under investment agreements negotiated in a post-NAFTA world.<sup>12</sup>

---

7. TPP, *supra* note 6, art. 9.

8. See, e.g., Guillermo Aguilar Alvarez & William W. Park, *The New Face of Investment Arbitration: NAFTA Chapter 11*, 28 YALE J. INT'L L. 365, 366 (2003) (noting that "[t]he past decade, however, has seen a noticeable sea change in outlook. Congress has enacted trade legislation giving evidence of an intention to restrict arbitration in investment treaties. And open criticism of investment arbitration has been voiced by significant elements of the media."); see also, Beth Simmons, *Bargaining Over BITs, Arbitrating Awards*, 66 WORLD POLITICS 12, 13 (2014) ("While investment treaties may indeed have facilitated some capital imports, researchers have neglected the other side of the coin: pushback from public actors who increasingly view the investment regime as currently constituted as not in their interest.").

9. See, Gilbert Gagne & Jean-Frederic Morin, *The Evolving American Policy on Investment Protection: Evidence from Recent FTAs and the 2004 Model BIT*, 9 J. OF INT'L ECON. L. 357, 367 (2006) ("Having learned from the NAFTA experience, the U.S. government has concluded FTAs that, as we will see in the next sections, provide, from the start, substantive and procedural safeguards for US authorities.").

10. See, Alvarez and Park, *supra* note 8, at 370 (arguing that, "[a]s Americans and Canadians began to understand the host state perspective, praise for arbitration's neutrality began to have competition in the form of complaints about infringement of national sovereignty and democracy.").

11. See *supra* note 6.

12. For an evaluation of the evolution in US investment agreements before CAFTA, see, for example, James E. Mendenhall, *The Evolving US Position on International Investment Protection*, in INVESTMENT TREATY LAW: CURRENT ISSUES V: THE REGIONALIZATION OF INTERNATIONAL INVESTMENT TREATY ARRANGEMENTS, 249, 250-52 (N. Jansen Calamita and Mavluda Sattorova, eds., 2015). For evaluations of the evolution in US investment agreements from NAFTA to DR-CAFTA, see, for example, Stephen Schwebel, *The United States 2004 Model Bilateral Investment Treaty: an Exercise in the Regressive Development of International Law*, in JUSTICE IN INTERNATIONAL LAW: FURTHER SELECTED WRITINGS, 152, 155-6 (2011); Amy K. Anderson,

The adoption of state-friendly provisions that expand the basis upon which respondents can justify governmental measures as legitimate regulations occurred—and continues to occur with the TPP—in a gradual and responsive rather than proactive manner.<sup>13</sup> States negotiated many of the substantive and procedural developments in investment treaties and free trade agreements in response to particular arbitral decisions that the negotiating states view as restrictions on legitimate government regulations in favor of expansive interpretations of investor rights and protections.<sup>14</sup>

This Article evaluates the ways in which the TPP's investment chapter marks an evolution from the major U.S.-negotiated investment agreements of the 2000s, particularly DR-CAFTA, in the agreements' treatment of investor protections and regulation.<sup>15</sup> This Article argues that the TPP continues the largely responsive evolution in international investment treaties and agreements by examining the TPP's departures from the United States' most recent

---

*Individual Rights and Investor Protections in a Trade Regime: NAFTA and CAFTA*, 63 WASH. & LEE L. REV. 1057 (2006); David A. Gantz, *The Evolution of FTA Investment Provisions: From NAFTA to the United States – Chile Free Trade Agreement*, 19 AM U. INT'L L. REV. 679 (2003); Mark Kantor, *The New Draft Model U.S. BIT: Noteworthy Developments*, 21 J. OF INT'L ARB. 383 (2004); Matthias Lehmann, *Options for Dispute Resolution Under the Investment Chapters of NAFTA and CAFTA*, 16 AM. REV. INT'L ARB. 387 (2005); Michael Muse-Fisher, *CAFTA-DR and the Iterative Process of Bilateral Investment Treaty Making: Towards a United States Takings Framework for Analyzing International Expropriation Claims*, 19 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 495 (2006).

13. The gradual evolution in investment treaties is primarily from the perspective of traditional capital-exporting states. For more on the responses to investment treaties on the part of traditionally capital importing states, see Suzanne Spears, *Making Way for the Public Interest in International Investment Agreements*, in *EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION*, 271, 273 (Chester Brown & Kate Miles eds., 2012) (arguing that “[a]t one extreme, a number of countries in Latin America have responded [to concerns about the potential for investment law to place undue constraints on sovereign regulatory power] by denouncing or insisting on the renegotiation of some of the their IIAs. . . . Countries in Southern and Eastern Africa have been more moderate in their response – rather than rejecting the IIA and investor state dispute-resolution regime, they have adopted a comprehensive investment promotion treaty among themselves, with different provisions from traditional IIAs.”); see also M. Sornarajah, *The Descent into Normlessness*, in *EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION* 631, 640 (Chester Brown & Kate Miles eds., 2012) (arguing “that many States which have been at the wrong end of the stick have withdrawn or are contemplating withdrawal.”).

14. Nathalie Bernasconi-Osterwalder, *How the Investment Chapter of the Trans-Pacific Partnership Falls Short*, INT'L INST. FOR SUSTAINABLE DEV. (Nov. 6, 2015), <http://www.iisd.org/commentary/how-investment-chapter-trans-pacific-partnership-falls-short> (claiming “the TPP investment chapter is an example of governments playing ‘catch-me-if-you-can,’ with new formulations that respond to recent cases where arbitrators have ruled against government measures that were largely perceived as legitimate or unchallengeable as an international violation.”); see, also, Gilbert Gagne & Jean-Frederic Morin, *supra* note 10, at 359 (arguing “[t]he changes in [US-negotiated investment agreements] must be seen as the result of a learning process from the US administration, rather than the consequences of new political powers or economic interests. It is a reaction to claims filed by foreign investors under NAFTA Chapter 11, several of these perceived as ‘frivolous’ by the American government, that the new features of recent US FTAs and the revised model BIT aim to reach a better balance between the protection of investment and the protection of state sovereignty.”).

15. See *supra* note 13 and accompanying text.

investment treaties and agreements in light of the arbitral decisions driving those changes.<sup>16</sup> The TPP is best understood as a geographical extension or harmonization of the investor-state arbitration regime codified in the United States' existing free trade agreements, with some additional clarifications intended to constrain the rights and remedies available to investors, rather than a significant revision of the international investment framework for investment protection and arbitration that the United States has developed.<sup>17</sup> For many of the negotiating states, this geographical extension of treaty coverage to protect investments may be the TPP's most significant legacy.<sup>18</sup>

Despite these efforts to strengthen the basis upon which governments can regulate without fear of losing costly arbitrations, a closer examination of the TPP's modifications to previous U.S.-negotiated investment agreements reveals the rather modest curtailment of investor protections. The next section of this Article will examine the new provisions in the TPP that seek to guide arbitral tribunals' determinations of the treatment that host states must provide for investors. These modifications are primarily expressed through additional interpretative guidance seeking to clarify the fundamental obligations states owe investors under most investment agreements: national treatment, most-favored nation treatment, minimum standard of treatment, and expropriation. The third section then evaluates modifications more directly targeted at prohibiting specific types of claims and strategies that investors have employed in investment arbitration. The fourth section both addresses the areas in which the TPP expands investor protections and explores continuities with past U.S.-negotiated investment agreements.

Throughout, this Article argues that the TPP's moderate changes to past U.S.-negotiated investment agreements demonstrate a gradual evolution in investment treaties largely in response to specific arbitral decisions and their progeny, rather than a broader reorientation of the United States' global investment regime.

---

16. See, e.g., Gilbert Gagne & Jean-Frederic Morin, *supra* note 10, at 382 (arguing that, "[a]bove all, such changes are intended to lessen the possibilities of a replication of the claims under NAFTA where the investor-state provisions have been perceived by NAFTA members as being abused by foreign investors.").

17. Julien Chaisse, *The Regulation of Investment in the TPP: Towards a Defining International Agreement for the Asia-Pacific Region*, in INVESTMENT TREATY LAW CURRENT ISSUES: VOLUME V: THE REGIONALIZATION OF INTERNATIONAL INVESTMENT TREATY ARRANGEMENTS, 103, 104-05 (N. Jansen Calamita & Mavluda Sattorova, eds., 2015) ("[E]mphasizing that the TPP is a vital test from the perspective of innovations in investment rule making for two main reasons. Firstly, the TPP will essentially draw on US rule-making and investment litigation practices rather than on the existing Asian PTAS . . . it also implies the US-inspired investment rule-making is about to achieve global status. Secondly, the TPP must be understood in the context of US investment rule-making and more broadly US foreign policy.").

18. *Id.* at 134 (demonstrating that "[f]rom a quantitative point of view, Brunei, Canada, Japan, Peru, Mexico and the US are the countries that benefit the most from the investment negotiations since the TPP fills a gap in the geographical coverage of the IIAs."); see also IAN F. FERGUSSON, MARK A. MCMINIMY, BROCK R. WILLIAMS, *supra* note 2, at 2.



## II.

## NEW PROVISIONS AND MODIFICATIONS IN THE TPP

The investment chapter in the TPP governs obligations host-states owe foreign investors, practices for determining breaches of those obligations, and mechanisms through which investors and states resolve disputes. The TPP's investment chapter closely resembles the draft 2012 U.S. Model BIT and only grew closer to the draft 2012 U.S. Model BIT during the final year of negotiations after WikiLeaks leaked a working version of the TPP's investment chapter.<sup>19</sup> The similarities between the TPP's investment chapter and the 2012 U.S. Model BIT demonstrate the amount of leverage the U.S. had in the negotiating process as well as the extent of convergence within the United States' international investment regime.<sup>20</sup>

The negotiating states adopted language that reformulates or clarifies the standards of treatment used to establish violations of a host-state's obligations to constrain arbitral tribunals from expansively interpreting the rights states must afford investors under the TPP.<sup>21</sup> This interpretative language often begins with "[f]or greater certainty" and exists to guide tribunals in their interpretation towards an already-existing understanding between the negotiating parties rather than to fundamentally alter the host-states' obligations under the investment agreement.<sup>22</sup> Rather than create an explicit and broad exception for state regulation that could destabilize the existing international framework of investment agreements, the TPP employs the aforementioned interpretative assistance to frame arbitral tribunals' interpretations of the treaty text. By refining existing obligations, the TPP also helps produce a consistent jurisprudence of international investment law by harmonizing the interpretation of the investor-protections across investment agreements.<sup>23</sup> This approach towards negotiating future investment agreements indicates a faith in the foundation of the existing international investment regime.

Commentators dispute whether such additional host-state friendly modifications are either necessary to optimize the wealth producing flow of

---

19. Cf. WikiLeaks Investment Chapter, *supra* note 6, with TPP, *supra* note 6. See also Douglas Thompson, *TPP Made Public at Law*, GLOBAL ARBITRATION REV., (Nov. 5, 2015), <http://globalarbitrationreview.com/news/article/34308/tpp-made-public-last/> (arguing that, "[i]f anything, the final text has been observed to be closer to the US Model BIT than a draft version that was leaked in March. Certain language that had been marked for possible omission in the draft has been restored, albeit with minor changes.").

20. Julien Chaisse, *supra* note 18, at 104; see also, Douglas Thompson, *supra* note 20 (arguing, "[a]s was widely predicted, the text's investment chapter follows that of the 2012 US Model bilateral investment treaty."). For arguments on the convergence in international investment agreements, see Karen Halverson Cross, *Converging Trends in Investment Treaty Practice*, 38 N.C. J. INT'L L. & COM. REG. 152 (2012).

21. Spears, *supra* note 13, at 275.

22. See, e.g., TPP, *supra* note 6, art. 9.5(4).

23. See Stephen Schill, *Multilateralizing Investment Treaties through Most-Favored-Nation Clauses*, 27 BERKELEY J. INT'L L. 496, 561 (2009).

investment or adequate to protect legitimate state regulations.<sup>24</sup> Despite this disagreement, the TPP's investment chapter exists within a broader trend of parties' "attempting to rein in investor protection provisions and instead protect host states' rights to adopt laws and policies to promote public welfare" when negotiating investment agreements.<sup>25</sup> This Article argues that critics of state-friendly modifications have exaggerated the effect of those modifications on investor protection in the United States' investment treaties,<sup>26</sup> just as critics of investor-state arbitration have overstated the threat arbitration poses to legitimate regulations.<sup>27</sup> Advocates for investment arbitration claim that newer, U.S.-negotiated investment agreements have "shrunk, sometimes dramatically, virtually every right originally accorded to foreign investors while at the same time increasing, sometimes vastly, the discretion accorded host states."<sup>28</sup> These claims are simultaneously too pessimistic concerning the impact of modifications primarily intended to clarify existing obligations and too optimistic concerning the long-term durability of the international investment regime in the face of significant domestic challenges in both developed and developing nations absent some concessions to the state's right to regulate for public welfare.<sup>29</sup>

Indeed, the political pressures against investor-state arbitration following the collapse of the traditional distinction between capital-exporting and capital-importing states after NAFTA led some commentators to note the durability of

---

24. Daniel Behn, *Legitimacy, Evolution, and Growth in Investment Treaty Arbitration: Empirically Evaluating the State-of-the-Art*, 46 GEO. J. INT'L L. 363, 368 (2014) (arguing that, "[i]t is less clear that investment treaty arbitration favors claimant-investors. Previous empirical scholarship demonstrates that the win rate for claimant-investors remains relatively low." The United States has never lost a case. So why rewrite the rules in a more host-state-friendly manner?").

25. Meredith Wilensky, *Reconciling International Investment Law and Climate Change Policy: Potential Liability for Climate Measures under the Trans-Pacific Partnership*, 45 ENVTL. L. REV. 10683, 10697 (2015).

26. Spears, *supra* note 13, at 295 (arguing "just because [newer investment agreements] direct tribunals to engage in balancing and place some non-investment policy objectives on the same normative plane as investment policy objectives, new generation IIAs should not be seen as more analytically decisive than they actually are with regard to host States' regulatory interests."). For overly pessimistic accounts of the new provisions in the TPP constraining investor protections, see Alex Lawson, *TPP Investment Text Raises Questions About Old Accords*, LAW360, (Nov. 9, 2015), <http://www.law360.com/articles/724308/tpp-investment-text-raises-questions-about-old-accords> (quoting "[i]f I am an investor, I really prefer Chapter 11 of the NAFTA over Chapter 9 of the TPP because there are fewer ways the government can avoid having to pay."); Donald Robertson, *Trade Deals: ISDS in the Newly Signed TPP*, GLOBAL ARBITRATION REV., (Nov. 11, 2015), <http://globalarbitrationreview.com/journal/article/34267/trade-deals-isds-newly-signed-tpp/> (arguing "[t]he unfortunate modern habit of seeking to 'write' the exception has the ability to stultify the development of general principles of law and create loopholes that progressively need to be filled by further prolix drafting.").

27. For criticisms, see, e.g., Lise Johnson & Lisa Sachs, *The TPP's Investment Chapter: Entrenching, Rather than Reforming, a Flawed System*, COLUM. CTR. ON SUSTAINABLE INV. POL'Y PAPER (2015).

28. José Enrique Alvarez, *The Return of the State*, 20 MINN. J. INT'L L. 223, 235 (2011).

29. See Sornarajah, *supra* note 13.

the arbitration mechanism depends upon its adaption in response to political realities:

If investment arbitration is to fulfill its promise, however, some mechanism must be found to promote greater sensitivity to vital host state interests. Otherwise, investor/government arbitration may fall prey to public pressure arising from a backlash against investor victories in some of the more visible NAFTA arbitrations. In the larger picture, arbitration's wisdom may have to accommodate political reality.<sup>30</sup>

The requirement that arbitration accommodate a political backlash in response to particular arbitral decisions or even merely defeated claims brought against the states that historically most strongly supported investor-state arbitration—particularly the United States—finds expression in the TPP's state-friendly modifications of past investment agreements.<sup>31</sup> This gradual retreat from the more investor-friendly provisions in earlier investment agreements is not unique to the negotiation of the TPP.<sup>32</sup> The free trade agreements negotiated after NAFTA left no doubt that the United States intended to weaken investor protection, even in agreements such as the United States-Chile FTA, where the likelihood of claims brought against the United States by Chilean investors is minimal relative to the risks for American investors abroad.<sup>33</sup> Nonetheless, as section III will demonstrate, the TPP maintains the fundamental protections states must afford investors.

#### A. *Changes Reducing Investor Protections*

##### 1. *Like Circumstances and Governmental Regulation*

TPP 9.4, note 14	For greater certainty, whether treatment is accorded in “like circumstances” under Article 9.4 (National Treatment) or Article 9.5 (Most-Favoured-Nation Treatment) depends on the totality of the circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives
------------------	--

30. Aguilar Alvarez & Park, *supra* note 8, at 399.

31. See, e.g., *infra* Section II.B(1).

32. See *supra*, note 13.

33. Gantz, *supra* note 13, at 767 (“While it may quell some of the NAFTA, Chapter 11 critics who are concerned about the United States as respondent host government, it is at least a partial retreat from the high level of protection afforded to investors in the past under the more traditional U.S. and other bilateral investment treaties and under NAFTA, Chapter 11.”); see also, Ling Ling He & Razeen Sappideen, *Investor-State Arbitration: The Roadmap from the Multilateral Agreement on Investment to the Trans-Pacific Partnership Agreement*, 40 FED. L. REV. 207, 226 (2012) (claiming, “these changes reflect a policy shift by States, whereby the rights of foreign investors are to be balanced against national public policy based interests and legislation.”).

The TPP's first substantive point of diversion from previous U.S.-negotiated investment agreements, including the draft 2012 U.S. Model BIT, is an interpretative footnote intended to clarify the negotiating parties' understanding of "like circumstances." This footnote assists tribunals attempting to determine whether a government has provided treatment that fulfills the National Treatment obligations under Article 9.4 and Most-Favored-Nation Treatment obligations under Article 9.5. The National Treatment article requires each Party accord to investors and investments of another Party "treatment no less favorable than that it accords, in like circumstances," to its own investors or investments in its territory of its own investors "with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."<sup>34</sup> The Most-Favored-Nation article establishes identical obligations relative to investors and the investments of any other Party or non-Party.<sup>35</sup>

Arbitral tribunals have adopted very different interpretations of "like circumstances," specifically invoking varied understandings of a "like investor" for the purposes of non-discrimination.<sup>36</sup> The TPP's footnote that clarifies "like circumstances" provides more general interpretive assistance than many other recent investment agreements that go to greater lengths to specify the factors evaluated in the "totality of circumstances."<sup>37</sup> Unlike the 2015 Draft Norwegian

---

34. TPP, *supra* note 6, art. 9.4(1-2).

35. *Id.* art. 9.5(1-2).

36. See Spears, *supra* note 13, at 285 (arguing, "[t]hus, for example, the tribunal in *Occidental v. Ecuador* provoked alarm when it adopted a very broad definition of 'like' investor, comparing the treatment accorded to a foreign oil company with the treatment accorded to exporters in general, rather than with the treatment of domestic oil companies. Other tribunals have adopted more tailored definitions of 'like' . . . In the case of *Parkerings v. Lithuania*, for example, the tribunal held that no discrimination had occurred when a foreign investor's car-parking project was treated differently from a domestic investor's project, because the foreign investor's project was with a section of Vilnius designated by UNESCO as a World Cultural Heritage site."); see also, Susan D. Franck, *Occidental Exploration & Production Co. v. Republic of Ecuador. Final Award. London Court of International Arbitration Administered Case No. UN 3467*, 99 AM. J. INT'L L. 675 (2005).

37. Cf. Draft 2015 Draft Norwegian Model BIT, art. IV, note 1, <https://www.regjeringen.no/contentassets/e47326b61f424d4c9c3d470896492623/draft-model-agreement-english.pdf> (specifying that "a measure applied by a government in pursuance of legitimate policy objectives of public interest such as the protection of public health, human rights, labour rights, safety, and the environment, although having a different effect on an investment or investor of another Party, is not inconsistent with national treatment and most favoured nation treatment when justified by showing that it bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investment."). See also, Common Market for Eastern and Southern Africa Common Investment Area Agreement, art. 17(2), May 23, 2007, [http://www.tralac.org/wp-content/blogs.dir/12/files/2011/uploads/Investment\\_agreement\\_for\\_the\\_CCIA.pdf](http://www.tralac.org/wp-content/blogs.dir/12/files/2011/uploads/Investment_agreement_for_the_CCIA.pdf) (specifying that references to 'like circumstances' "requires an overall examination on a case by case basis of all the circumstances of an investment including, inter alia: (a) its effects on third persons and the local community; (b) its effects on the local, regional or national environment, including the cumulative effects of all investments within a jurisdiction on the environment, (c) the sector the investor is in; (d) the aim of the measure concerned; (e) the regulatory process generally applied in relation to the measure concerned; and (f) other factors directly relating to the investment or investor in relation to the measure concerned; and the examination shall not be limited to or be biased towards any one

Model BIT or the Common Market for Eastern and Southern Africa Common Investment Area Agreement, the TPP only notes that the “totality of the circumstances” includes “whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives.”<sup>38</sup> The TPP’s language that clarifies “like circumstances” bears some resemblance to the test adopted in *Pope & Talbot Inc. v. Canada (Pope & Talbot)*, where the tribunal held a governmental measure must possess a “reasonable nexus to rational government policies that (1) do not distinguish, on their face or *de facto*, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA.”<sup>39</sup>

The negotiating parties also released a Drafters’ Note on the interpretation of “in like circumstances” to “ensure that tribunals follow the existing approach set out” in the Drafters’ Note.<sup>40</sup> The Drafters’ Note clarifies that Articles 9.4 (National Treatment) and 9.5 (Most-Favored-Nation Treatment) “do not prohibit all measures that result in differential treatment,” but instead prohibit only those measures that treat foreign investors and their investments “less favorably on the basis of their nationality.”<sup>41</sup> As with similar provisions guiding tribunals’ interpretation of Article 9.6 (Minimum Standard of Treatment),<sup>42</sup> the Drafter’s Note requires a tribunal find discriminatory intent on the part of the host-state and thus also creates a permissible basis for differential treatment “based on legitimate public welfare objectives.”<sup>43</sup>

In clarifying the meaning of this language, the Drafters’ Note explicitly endorses a line of NAFTA tribunal decisions that employ a similar methodology for evaluating “like circumstances.” The Drafters’ Note cites *Grand River Enterprises Six Nations Ltd., et al. v. United States of America* for the proposition that evaluation of “like circumstances” requires evaluating the legal regimes governing sectors of the economy within which the investor acts.<sup>44</sup> The Drafters’ Note also cites *GAMI Investments Inc. v. United Mexican States* as an example of a tribunal that determined a foreign investor failed to demonstrate like circumstances when differential treatment was “plausibly connected with a

---

factor.”), *quoted in*, Spears, *supra* note 13, at 287.

38. Spears, *supra* note 13, at 287.

39. *Pope & Talbot Inc. v. The Government of Canada*, Award on the Merits of Phase 2, (UNCITRAL, April 10 2001), para. 78.

40. TPP Drafters, *Drafters’ Note on Interpretation of “In Like Circumstances” Under Article 9.4 (National Treatment) and Article 9.5 (Most-Favored-Nation Treatment)*, November 5, 2015, <https://www.tpp.mfat.govt.nz/assets/docs/Interpretation%20of%20In%20Like%20Circumstances.pdf> (“Drafter’s Note”).

41. *Id.*

42. *See infra*, section II(A)(ii).

43. Drafter’s Note, *supra* note 43.

44. *Id.* para. 5, (citing *Grand River Enterprises Six Nations Ltd., et al. v. United States of America*, Award, (UNCITRAL, January 12, 2011), paras. 166-67 in support of the proposition that “NAFTA tribunals have also accepted distinctions in treatment between investors or investments that are plausibly connected to legitimate public welfare objectives, and have given important weight to whether investors or investments are subject to like legal requirements.”).

legitimate goal of policy . . . and was applied neither in a discriminatory manner nor as a disguised barrier to equal opportunity.”<sup>45</sup> Finally, the Drafters’ Note approvingly cites *Pope & Talbot* for the proposition quoted above.<sup>46</sup>

Overall, the negotiating parties’ provisions guiding tribunals’ interpretation of “like circumstances” creates additional room for governmental regulation. The interpretive guidance requires an arbitral tribunal to examine whether the measure in question has a legitimate regulatory purpose when evaluating the otherwise unrelated “like circumstances” component of a MFN or national treatment claim.<sup>47</sup> The TPP’s requirement that tribunals evaluate legitimate regulatory purposes when adjudicating MFN and national treatment claims is particularly significant as an expansion of legitimate regulation into each of foundational rights that states must afford investors: most-favored nation treatment, national treatment, minimum standard of treatment, and just compensation for expropriation.<sup>48</sup> While the adjudication of claims brought under the expropriation and minimum standard of treatment provisions in almost any U.S.-negotiated investment agreement requires examination of the legitimacy of the government measure’s regulatory purpose, the MFN and national treatment articles would possess no such requirement absent this footnote. That the footnote was not included in the 2012 U.S. Model BIT<sup>49</sup>—and was included only as tentative language with at least one state still consulting and at least one other state still considering the footnote when Wikileaks released the draft TPP investment chapter<sup>50</sup>—implies resistance from the more investor-friendly negotiating parties.

The inclusion of the “like circumstances” footnote thus signals a broader urgency on the part of the negotiating parties to explicitly direct tribunals to consider whether there exists a legitimate public welfare justification for a governmental measure, while maintaining an adequate level of investor protection. Even while expanding the number of claims that require the tribunal to account for the legitimacy of governmental regulation, the “like circumstances” footnote seeks to maintain investor protection by remaining silent on how tribunals should weigh the various factors that constitute “like circumstances.” Without specifying how to balance the conflicting

---

45. Drafter’s Note, *supra* note 43 (citing *GAMI Investments Inc. v. United Mexican States*, Award, (UNCITRAL, November 15, 2004), paras. 111-15).

46. Drafter’s Note, *supra* note 43, para. 5.

47. TPP, *supra* note 6, art. 9.4, note 14.

48. See *infra* sections II.A(2) and II.A(3) for demonstrations of the ways in which the TPP requires consideration of a host-states’ legitimate regulatory purposes when adjudicating claims brought under the expropriation and minimum standard of treatment provisions.

49. U.S. Dep’t of State, [Draft] Treaty Between the Government of the United States of America and the Government of [Country] Concerning the Encouragement and Reciprocal Protection of Investment, April 20, 2012, <http://www.state.gov/documents/organization/188371.pdf> [hereinafter, “2012 US Draft Model BIT”].

50. WikiLeaks Investment Chapter, *supra* note 6, note 12.

considerations, the TPP leaves open the possibility that a tribunal could determine that the state employed the governmental measure with discriminatory intent, even if connected to a legitimate public welfare justification.<sup>51</sup> The adjudication of “like circumstances” would then involve the proportionality examination tribunals have employed for similar considerations, wherein the strength of the legitimate government interest is weighed against the investor’s economic harm.<sup>52</sup> By incorporating this type of proportionality examination into MFN and national treatment claims through the “like circumstances” note, the TPP requires tribunals to consider the legitimacy of public welfare objectives when interpreting any of substantive provisions under which investors can bring claims.

## 2. *Investor Expectations*

TPP 9.6(4) (Minimum Standard of Treatment)	Annex 9-B (Expropriation), Footnote 36
For greater certainty, the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor’s expectations does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result.	[modifying Annex 9-B(3)(a)(ii): The extent to which the government action interferes with distinct, reasonable investment-backed expectations;] For greater certainty, whether an investor’s investment-backed expectations are reasonable depends, to the extent relevant, on factors such as whether the government provided the investor with binding written assurances and the nature and extent of governmental regulation or the potential for government regulation in the relevant sector.

The TPP’s treatment of investor expectations marks another clear mechanism through which the negotiating parties sought to narrow an arbitral tribunal’s ability to create expansive investor protections under both Article 9.6 (Minimum Standard of Treatment) and Article 9.7 (Expropriation). First, in Article 9.6, the TPP includes interpretative guidance not found in past U.S.-negotiated investment agreements or model BITs to clarify that a host-State’s failure to fulfill investor expectations alone does not constitute a breach of the minimum standard of treatment under the TPP.<sup>53</sup> More significantly, the

51. TPP, *supra* note 6, art. 9.4, note 14 (including “legitimate public welfare objectives” as only one of many factors that compose “the totality of the circumstances”).

52. See *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/002/2, Award (May 29, 2003) [hereinafter “*Tecmed*”].

53. Cf. TPP, *supra* note 6, art. 9.6(4) with 2012 US Draft Model BIT, *supra* note 52.

negotiating parties also included language to guide a tribunal's evaluation of investors' investment backed expectations for the purposes of expropriation in Annex 9-B.<sup>54</sup>

The evolution of investment treaty guidance concerning the adjudication of expropriation claims exemplifies the process by which U.S.-negotiated investment treaties have evolved since NAFTA. NAFTA Article 1110 (Expropriation and Compensation) contained only the vaguest definition of expropriation, coming closest when stating, "[n]o Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ('expropriation')."<sup>55</sup> In response to a number of tribunals constituted under NAFTA reading Article 1110 in a manner that, according to some U.S. commentators, provided foreign investors with greater protections than domestic investors,<sup>56</sup> the negotiating parties in the BIT's and FTAs of the 2000s began to include an annex defining the negotiating parties' understanding of expropriation. First, U.S.-negotiated investment agreements after NAFTA included additional clauses—maintained in the TPP—specifying that, "except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations."<sup>57</sup> The TPP retains this provision with an additional footnote clarifying the public health component of legitimate public welfare objectives.<sup>58</sup>

Additionally, U.S.-negotiated investment agreements after NAFTA defined indirect expropriation with standards that closely track those that the U.S. Supreme Court established in its takings jurisprudence.<sup>59</sup> In CAFTA, Annex 10-C requires tribunals examine on a case-by-case basis, "(i) the economic impact of the government action. . . (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and (iii) the character of the government action."<sup>60</sup> The TPP takes this requirement a step further than any previous U.S.-negotiated investment agreement, including the

---

54. TPP, *supra* note 6, 9.6(4).

55. North American Free Trade Agreement, U.S.-Can.-Mex., Dec 17, 1992, H.R. Doc. No. 103-159, vol. I, art. 1110 (1993).

56. David Singh Grewal & Marco Simons, *The Case Against ISDS*, BALKINIZATION (June 8, 2015), <http://balkin.blogspot.com/2015/06/the-case-against-isds.html>, citing *Tecmed*, *supra* note 55.

57. The Dominican Republic-Central America-United States Free Trade Agreement Implementation Act, *publ.*, Aug. 2, 2005, 119 Stat. 462, Annex 10-C(4)(b) [hereinafter "CAFTA"].

58. TPP, *supra* note 6, Annex 9-B (Expropriation), note 37 (stating, "[f]or greater certainty and without limiting the scope of this subparagraph, regulatory actions to protect public health include, among others, such measures with respect to the regulation, pricing and supply of, and reimbursement for, pharmaceuticals (including biological products), diagnostics, vaccines, medical devices, gene therapies and technologies, health-related aids and appliances and blood and blood-related products.").

59. See, Michael Muse-Fisher, *supra* note 13.

60. CAFTA, *supra* note 61, Annex 10-C.



2012 U.S. Draft Model BIT, by providing interpretative guidance for an arbitral tribunal's evaluation of "reasonable investment-backed expectations" under the definition of an indirect expropriation in Annex 9-B(3)(a)(ii).<sup>61</sup> The TPP's specification of the conditions that define "reasonable investment-backed expectations" narrows the category of government-induced reasonable expectations in two significant ways.<sup>62</sup>

First, the TPP specifies that reasonable investment-backed expectations are contingent upon "the nature and extent of governmental regulation or the potential for government regulation in the relevant sector."<sup>63</sup> Here, the negotiating states, at a bare minimum, embrace a holding from *Saluka Investments B.V. v. The Czech Republic*, which examined investor expectations and found:

[n]o investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well.<sup>64</sup>

The TPP's provisions that govern the evaluation of reasonable investment-backed expectations shift the scale even more heavily towards the host state. The language in *Saluka* creates a balancing test between the investor's reasonable investment-backed expectations and the legitimate right to regulate domestic matters in the public interest. However, the language of the TPP requires that the legitimate right to regulate domestic matters reduces the investor's reasonable expectations before a tribunal can balance those expectations with the right to regulate.<sup>65</sup> In other words, the legitimate right to regulate counts twice. First, the arbitral tribunal must minimize the investor's expectations to account for the potential for regulation in the relevant sector. Second, the tribunal balances those expectations against the legitimacy of the regulation under language presuming the legitimacy of "non-discriminatory regulatory actions by a Party that are designed and intended to protect legitimate public welfare objectives."<sup>66</sup>

While the TPP's provisions that elucidate the term "reasonable investment-backed expectations" is not present in the draft 2012 U.S. Model BIT, the United States had argued as a defendant in cases brought under NAFTA Chapter 1110 that, "although regulation is no excuse for expropriation, 'where an industry is already highly regulated, reasonable extensions of those regulations

---

61. TPP, *supra* note 6, Annex 9-B.

62. *Id.* Annex 9-B and note 36.

63. *Id.*

64. *Saluka Investments B.V. v. The Czech Republic*, Partial Award, (UNCITRAL, Marc. 17, 2006) paras. 305, 309.

65. TPP, *supra* note 6, Annex 9-B.

66. TPP, *supra* note 6, Annex 9-B.3(b). Note, however, that the provision includes language allowing a tribunal to determine otherwise; the aforementioned regulatory actions "do not constitute indirect expropriations, except in rare circumstances." *Id.*

are foreseeable.”<sup>67</sup> The inclusion of these provisions embraces the holding in *Glamis Gold*, where

[t]he reasonableness of the expectations may depend on the regulatory climate existing at the time the property was acquired, in the particular sector in which the investment was made. Consideration of whether an industry is highly regulated, for example, or whether the investment involved development of environmentally sensitive areas, is a standard part of the legitimate expectations analysis.<sup>68</sup>

Thus, the TPP’s provision guiding a tribunal’s interpretation of “reasonable investment-backed expectations” significantly strengthens a State’s ability to regulate, particularly in extensively regulated areas such as environment and labor, without becoming immediately liable for the potential violation of investment-backed expectations.

The TPP’s clarification of reasonable expectations is a direct response to a number of cases brought under previous investment agreements that determined certain government measures constituted indirect expropriation for undermining foreign investor’s investment-backed expectations. In *Metalclad Corporation v. The United Mexican States*, an arbitral tribunal constituted under NAFTA held that an indirect expropriation occurred even when a municipality denied the Claimant a local construction permit, because the Claimant was able to claim its investment-backed expectations relied on non-written representations from federal officials.<sup>69</sup> The TPP’s implicit response to the holding in *Metalclad* would require the arbitral tribunal to evaluate the likelihood for regulation in the waste disposal sector and to treat only binding, written assurances as an adequate basis upon which the Claimant can establish reasonable investment-backed expectations.<sup>70</sup>

The TPP also rejects the approach taken by a tribunal constituted under the Mexico-Spain BIT in *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States* (“*TecMed*”), which found that commitments could be inferred in statements made by a government official when examining fair and equitable treatment.<sup>71</sup> By implicitly providing that “binding written assurances” would

---

67. Lee M. Caplan & Jeremy K. Sharpe, *United States*, in COMMENTARIES ON SELECTED MODEL INVESTMENT TREATIES, 755, 790-91 (Chester Brown, ed., 2013), citing *Glamis Gold, Ltd. v. The United States of America*, Award, (UNCITRAL, June 8, 2009) 91 [hereinafter “*Glamis Gold*”].

68. Caplan & Sharpe, *supra* note 71, at 790, citing *Glamis Gold*, *supra* note 71, at 91.

69. *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award (August 30, 2000), paras. 102-12 (holding “[b]y permitting or tolerating the conduct of Guadalcázar in relation to Metalclad which the Tribunal has already held amounts to unfair and inequitable treatment breaching Article 1105 and by thus participating or acquiescing in the denial to Metalclad of the right to operate the landfill, notwithstanding the fact that the project was fully approved and endorsed by the federal government, Mexico must be held to have taken a measure tantamount to expropriation in violation of NAFTA Article 1110(1).”) [hereinafter “*Metalclad*”]. For a summary of the holding in *Metalclad*, see Rachel D. Edsall, *Indirect Expropriation under NAFTA and DR-CAFTA: Potential Inconsistencies in the Treatment of State Public Welfare Regulations*, 86 B.U.L. REV. 931, 940 (2006).

70. See, TPP, *supra* note 6, Annex 9-B.

71. *Tecmed*, *supra* note 55, paras.158-74; *Metalclad*, *supra* note 73, paras 28-29.

supply an investor a reasonable basis for investment-backed expectations, the negotiating Parties appear to reject inferred assurances and non-written representations as a source of reasonable investment-backed expectations. However, similar to other changes made in the TPP from previous U.S.-negotiated investment agreements, this clarifying language only aims to guide a tribunal's determination while leaving significant discretion for a case-by-case application of the rules.

For the negotiating parties, the decisions of tribunals constituted under existing investment agreements serve not only as interpretations to foreclose, but also as sources of inspiration for provisions and interpretative guidance in future investment agreements. The TPP's modifications to previous investment agreements on the determination of investor expectations help guide TPP tribunals towards a reading more similar to *Methanex Corporation v. United States (Methanex)*. In *Methanex*, a NAFTA tribunal dismissed claims of indirect expropriation in a California executive order regulating the use of methyl tertiary-butyl ether.<sup>72</sup> The tribunal's determination closely resembles the language added to the TPP. *Methanex* stands for the proposition that:

a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which effects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.<sup>73</sup>

While the *Methanex* tribunal found this holding in a "principal of general international law,"<sup>74</sup> the TPP attempts to remove the possibility for courts to reach an alternative reading consistent with *Metalclad* by requiring an evaluation of the intent<sup>75</sup> of the governmental measure and "specific commitments" as a foundation for a reasonable investor's investment-backed expectations.<sup>76</sup> There is no question that partially conditioning the reasonability of investor's expectations on the "nature and extent of governmental regulation or the potential for government regulation in the relevant sector"<sup>77</sup> constrains an investor's ability to successfully bring claims for unlawful expropriation under the TPP. Given the extent of 21<sup>st</sup> century governmental regulation in the economic sectors where significant amounts of foreign investment occur,<sup>78</sup> the TPP shifts the foundation of investor expectations from assumptions and

---

72. *Methanex Corporation v. United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, (UNICTRAL, August 3, 2003) [hereinafter "*Methanex*"]. For a summary of the holding in *Methanex*, see, for example, Edsall, *supra* note 73, at 948.

73. *Methanex*, *supra* note 73, at 1456, para. 7.

74. *Id.*

75. Here, both the public benefit sought through the governmental measure and any suggestion of discriminatory treatment constitute intent.

76. For ways in which CAFTA's language differs from *Methanex*, see Edsall, *supra* note 73, at 958.

77. TPP, *supra* note 6, Annex 9-B.

78. See, e.g., the regulation of methyl tertiary-butyl ether in *Methanex*, *supra*, note 76.

inferences to binding commitments and written assurances. This modification significantly increases the government's ability to regulate without fear of violating the TPP's expropriation provision.

### 3. Minimum Standard of Treatment

TPP Annex 9-A	CAFTA Annex 11-B
The customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the investments of aliens	[T]he customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect economic rights and interests of aliens

The TPP also modifies the extent to which the customary international law minimum standard of treatment protects foreign investors under TPP Article 9.5 (Minimum Standard of Treatment), changing the scope of protection from "economic rights and interests of aliens" in CAFTA and the 2012 U.S. Model BIT to "investments of aliens."<sup>79</sup> Customary international law first appeared as the minimum standard of treatment in the United States' investment agreements after claimants tried to argue that NAFTA Article 1105(1) required host States provide treatment "in accordance with international law" and treatment exceeding that guaranteed under the minimum standard of treatment for aliens under customary international law.<sup>80</sup> Yet, tribunals have struggled to determine precisely what body of law or principles establishes the minimum standard of treatment since the introduction of such provisions. For example, the *Metalclad* tribunal found Mexico violated the minimum standard of treatment without reference to customary international law;<sup>81</sup> on the other hand, the *Pope & Talbot* tribunal concluded that the standard for fair and equitable treatment was "additive to the requirements of international law;"<sup>82</sup> and, finally, the *S.D. Myers* tribunal found a breach of the minimum standard of treatment in the host state's breach of the national treatment obligation.<sup>83</sup>

In response to these tribunals' decisions, the NAFTA Free Trade Commission supplied the three following clarifications concerning NAFTA Article 1105 in the July, 2001 Notes of Interpretation of Certain Chapter 11 Provisions:

- 1) Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment afforded to investments of investors of another party.

---

79. 2012 US Draft Model BIT, *supra* note 52, Annex A.

80. See Caplan & Sharpe, *supra* note 71, at 784.

81. Gilbert Gagne & Jean-Frederic Morin, *supra* note 10, at 369.

82. Caplan & Sharpe, *supra* note 71, at 793.

83. *Id.*

- 2) The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
- 3) A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).<sup>84</sup>

Nonetheless, there still exists significant disagreement among both States and tribunals over what customary international law specifically guarantees as the minimum standard of treatment that a host state must provide an investor.<sup>85</sup>

The lack of agreement regarding what customary international law principles protect offers one explanation for the narrowing scope of protection customary international law provides from the “economic rights and interests of aliens” in CAFTA to “the investments of aliens” in the TPP. In other words, because the applicable principles of customary international law are unclear, narrowing the scope of the protection those principles afford is one way in which the negotiating parties can limit their liability in the face of creative claimants in the future. If the argument advanced by Professors Schwebel and Spears<sup>86</sup> is correct in diagnosing significant disagreement on the substantive protections afforded by customary international law, the narrowing of the language in the TPP constrains arbitral tribunals from protecting economic rights and interests which are broader than those merely pertaining to the investment in dispute.

However, the TPP’s language, which describes customary international law principles that protect the investments of aliens, ascribes legitimacy to the argument that an emerging consensus on a customary international law exists, at least insofar as those principles of customary international law concern the protection of aliens’ investments.<sup>87</sup> In response to modifications in the U.S.

---

84. NAFTA FREE TRADE COMMISSION, NORTH AMERICAN FREE TRADE AGREEMENT NOTES ON INTERPRETATION OF CERTAIN CHAPTER 11 PROVISIONS, July 31, 2001, [http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding\\_e.asp](http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding_e.asp)

85. Spears, *supra* note 13, at 284 (describing “*Merril & Ring v. Canada*, held that today’s MST is broader than that defined in the *Neer* case and provides for the fair and equitable treatment of alien investors within the confines of ‘reasonableness’ . . . [while] [t]he second tribunal, in *Chemtura Corporation v. Canada* . . . stated . . . that MST is not confined to the kind of outrageous treatment referred to in the *Neer* case, but rather requires an analysis of the record as a whole to determine whether a government acted fairly, in keeping with due-process standard and in good faith when taking regulatory measures.”); *see also*, Schwebel, *supra* note 12, at 156 (arguing “[t]he profound, and startling, deficiency of the 2004 provision is that there is no agreement within the international community on the content of ‘customary international law’ on which the 2004 Model BIT relies. There was, and is, no agreement within the international community on the content of the ‘customary international law minimum standard of treatment of aliens,’ or even on whether such a minimum standard existed or exists.”).

86. *Supra* notes 12, 13

87. Stephen Schwebel, *Investor-State Disputes and the Development of International Law: The Influence of Bilateral Investment Treaties on Customary International Law*, 98 PROCEEDINGS OF THE ANNUAL MEETING AM. SOC’Y OF INT’L L. 27, 28 (2004) (arguing “when BITs prescribe treating the foreign investor in accordance with customary international law, they should be understood to mean the standard of international law embodied in the terms of some two thousand concordant

2004 Model BIT, Professor Schwebel raised concerns that the protections afforded under customary international law are meaningless as few nations agree in practice on the substantive protections relevant to investments that compose the customary international law minimum standard of treatment.<sup>88</sup> The TPP's provisions,<sup>89</sup> however, strongly imply that there now exists a body of customary international law that protects the investments of aliens. This implied body of law rejects the finding in *ADF Group Inc. v United States* that:

[w]e are not convinced that the Investor has shown the existence, in current customary international law, of a general and autonomous requirement (autonomous, that is, from specific rules addressing particular, limited, contexts) to accord fair and equitable treatment and full protection and security to foreign investments. The Investor, for instance, has not shown that such a requirement has been brought into the corpus of present day customary international law by the many hundreds of bilateral investment treaties now extant.<sup>90</sup>

Clearly, however, the parties negotiating the TPP believe a body of customary international law governing the treatment of investments now exists, specifying in Annex 9-A that "[t]he customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the investments of aliens."<sup>91</sup> Any cogent approach to interpreting the TPP must reject the otherwise unfounded claim that negotiating parties included vacuous language providing no protections. If customary international law provided no investment protections, there would be little reason to define the minimum standard of treatment with reference to customary international law.

Also worth observing is the decision by the negotiating parties not to include a more detailed definition of one the enumerated principles of customary international law: fair and equitable treatment.<sup>92</sup> While potentially narrowing the rights afforded under customary international law to those regarding the protection of an alien's investment, the parties negotiating the TPP chose not to specify the meaning of the minimum standard of treatment under customary international law in concrete terms.<sup>93</sup> As with all other recent U.S.-negotiated investment agreements, the TPP specifies that fair and equitable treatment includes, "the obligation not to deny justice in criminal, civil or administrative

---

BITs. The minimum standard of international law is the contemporary standard.").

88. Schwebel, *supra* note 12, at 156.

89. TPP, *supra* note 6, Annex 9-A.

90. *ADF Group Inc. v. United States of America*, ICSID Case No. ARB (AF)/00/1 Award (January 9, 2003) para. 183.

91. TPP, *supra* note 6, Annex 9-A.

92. TPP, *supra* note 6, art. 9.6.

93. For a summary of the elements of fair and equitable treatment, see Catherine Yannaca-Small, *Fair and Equitable Treatment in International Investment*, in INTERNATIONAL INVESTMENT LAW: A CHANGING LANDSCAPE, 79, 104 (OECD, 2005) (claiming fair and equitable treatment is constituted by four categories: "a) Obligation of vigilance and protection, b) Due process including non-denial of justice and lack of arbitrariness, c) Transparency and respect of investor's legitimate expectations and d) Autonomous fairness elements.").

adjudicatory proceedings in accordance with the principles of due process embodied in the principal legal systems of the world.”<sup>94</sup> However, the EU-Canada Comprehensive Economic and Trade Agreement (CETA), signed in 2014 during the TPP negotiations, provides a more detailed enumeration of possible violations of the fair and equitable treatment obligation.<sup>95</sup> CETA specifies that:

[A] party breaches the obligation of fair and equitable treatment. . . where a measure or series of measures constitutes: (a) Denial of justice in criminal, civil or administrative proceedings; (b) Fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings. (c) Manifest arbitrariness; (d) Targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief; (e) Abusive treatment of investors, such as coercion duress, and harassment; or (f) A breach of any further elements of the fair and equitable treatment obligation adopted by the Parties in accordance with paragraph 3 of this Article.<sup>96</sup>

An earlier draft of CETA also included transparency and legitimate expectations in the enumerated violations of fair and equitable treatment.<sup>97</sup>

The TPP groups the first and second breaches of obligations of fair and equitable treatment articulated in CETA, and likely accounts for the fifth enumerated violation in the TPP’s clarification that full protection and security “requires each Party to provide the level of police protection required under customary international law.”<sup>98</sup> While the language of CETA implies that the enumerated breaches of the obligation of fair and equitable treatment are an exhaustive list, the TPP only notes that fair and equitable treatment “includes the obligation not to deny justice.”<sup>99</sup> In this way, when compared with concurrently negotiated investment agreements, the TPP leaves significantly more discretion to arbitral tribunals in determining the specific manifestations of a breach of fair and equitable treatment.

The TPP also contains a provision not found in existing U.S. investment agreements that specifies that an investor bears the burden of proving all elements of its claims, including a claim brought alleging a host-state breached the Minimum Standard of Treatment.<sup>100</sup> This added provision seems intended to

---

94. TPP, *supra* note 6, art. 9.6(2)(a).

95. P. Dumberry, *Drafting the Fair and Equitable Treatment Standard Clause in the TPP and RCEP: Lessons Learned from the NAFTA Article 1105 Experience*, 12 TRANSNAT’L DISP. MGMT. 1, 26 (2015).

96. Comprehensive Economic and Trade Agreement, E.U.-Can., Aug. 2014, Art. 8.10, [http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc\\_152806.pdf](http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf).

97. Dumberry, *supra* note 98, at 27.

98. TPP, *supra* note 6, art. 9.6(2)(b).

99. *Id.* art. 9.6(2)(a).

100. *Id.* art. 9.22(7) (stating, “[f]or greater certainty, if an investor of a Party submits a claim under this Section, including a claim alleging that a Party breached Article 9.6 (Minimum Standard of Treatment), the investor has the burden of proving all elements of its claims, consistent with general principles of international law applicable to international arbitration.”).

enshrine a holding from *Glamis Gold, Ltd. v The United States of America*,<sup>101</sup> requiring that the claimant demonstrate an evolution of the customary fair and equitable treatment if claiming a breach that falls short of the standard established in *Neer v. Mexico*.<sup>102</sup> While it is unlikely that this new language constitutes a departure from the treatment of an investor's burden of proof in the status quo, this added provision in the TPP ensures tribunals do not deviate from the established allocation of the burden of proof in investor-state arbitration.

### *B. Changes Foreclosing Particular Claims and Claimant Strategies*

Along with clarifying the primary, substantive provisions of investor treatment that states must provide, the TPP also includes a number of provisions not found in previous U.S.-negotiated investment agreements to foreclose the possibility of particular claims and claimant strategies that host states have found particularly troublesome. As with the evolution in the provisions governing the obligations states owe investors, these more specifically tailored modifications to the TPP largely emerged in response to particular arbitral decisions that created a procedural system that unduly favored the investor in the eyes of the negotiating states.<sup>103</sup> This section will first examine the *Maffezini* line of cases and the TPP's response to the application of Most-Favored Nation provisions to the procedural components of investment agreements. This section will also address new provisions that the negotiating parties intended to foreclose claims brought exclusively on the basis of modifications to state subsidy schemes. Next, this section examines new provisions governing claims brought against the enforcement of conditions upon which investments are permitted under investment authorization legislation. Finally, this section notes language specifically permitting states to bring counterclaims against investors for the first time in a U.S.-negotiated investment agreement.

#### *1. Maffezini and Procedural Cherry-Picking*

TPP 9.5(3) (Most-Favored-Nation Treatment)	For greater certainty, the treatment referred to in this Article does not encompass international dispute resolution procedures or mechanisms such as those included in Section B.
--	--

101. *Glamis Gold, supra* note 71, para. 22.

102. *Neer v. Mexico*, 4 R. INT'L ARB. AWARDS 4 (Oct. 15, 1926) (holding that "[t]he treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.").

103. For a history of the procedural changes from NAFTA to the 2004 Model BIT, see, for example, Mark Kantor, *The New Draft Model U.S. BIT: Noteworthy Developments*, 21 J. OF INT'L ARB. 383 (2004).



The TPP's most-favored nation article includes a provision that limits the article's application to exclusively substantive investment provisions. Article 9.5 (3) reads:

For greater certainty, the treatment referred to in this Article does not encompass international dispute resolution procedures or mechanisms, such as those included in Section B.<sup>104</sup>

This limitation ensures that investors cannot circumvent the procedural provisions negotiated by each party to the agreement through recourse to procedural provisions more favorable to the investor in pre-existing agreements. In the context of the TPP and its relatively state-friendly provisions, this limitation is imperative: the parties to the agreement have already signed nearly five hundred agreements subject to the most-favored-nation article in the TPP.<sup>105</sup>

Critics of the TPP have nonetheless claimed that the inclusion of both a most-favored-nation provision and an investor-state arbitration mechanism would allow the investor to bypass the more state-friendly procedural provisions established under the TPP.<sup>106</sup> Critics point to a line of ICSID cases beginning with *Maffezini v. Spain*, finding it possible to apply most-favored-nation clauses to preconditions of arbitration and dispute resolution mechanisms.<sup>107</sup> Cumulatively, tribunals have not established a consistent jurisprudence in their attempt to resolve the doctrinal debate surrounding the extension of most-favored-nation clauses to a treaty's arbitration provisions.<sup>108</sup>

---

104. TPP, *supra* note 6, art. 9.5(3)

105. Chaisse, *supra* note 18, at 138; *see also*, Thompson, *supra* note 20 (arguing the most-favored-nation clause restriction present in the TPP "no doubt derives from the efforts of investors in a line of ICSID cases beginning with *Maffezini v. Spain* to argue that MFN clauses should apply to preconditions to arbitration and dispute resolution clauses.").

106. *See, e.g.*, Todd Tucker, *The TPP Has a Provision Many Will Love to Hate: ISDS. What Is It, and Why Does It Matter?* WASH. POST, (Oct. 6, 2015), <https://www.washingtonpost.com/blogs/monkey-cage/wp/2015/10/06/the-tpp-has-a-provision-many-will-love-to-hate-isds-what-is-it-and-why-does-it-matter/> (claiming the most-favored-nation provision could "allow investors to claim the best procedural and substantive treatment contemplated in any of a host country's treaties. This is particularly useful where the treaty that the investor used as its vehicle is more state-friendly (say TPP, arguably) than others in the respondent's treaty portfolio."). *But, see* Stephen Schill, *Multilateralizing Investment Treaties through Most-Favored-Nation Clauses*, 27 BERKELEY J. INT'L L. 496, 561 (2009) ("Seeking the most favorable protection offered by the BITs of a specific host State is therefore not a shopping for unwarranted advantages, but the core objective of MFN clauses . . . application of MFN clauses [to matters of jurisdiction] harmonizes compliance procedures for the host State's obligations under investment treaties.").

107. Emilio Agustín Maffezini v. The Kingdom of Spain, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction, (Jan. 25, 2000) para. 56 (holding "that if a third-party treaty contains provisions for the settlement of disputes that are more favorable to the protection of the investor's rights and interests than those in the basic treaty, such provisions may be extended to the beneficiary of the most favored nation clause as they are fully compatible with the *ejusdem generis* principle.").

108. For a summary of the existing tension in tribunals' jurisprudence, *see* AIKATERINI TITI, *THE RIGHT TO REGULATE IN INTERNATIONAL INVESTMENT LAW* 137, note 704 (2013).

However, every U.S.-negotiated investment agreement after CAFTA has limited the scope of application for the most-favored-nation provision in a manner similar to the TPP. The final draft text of CAFTA released by the United States included an interpretive footnote stating that the parties understood that the most-favored-nation clause does not apply to investor-state dispute settlement and “therefore could not reasonably lead to a conclusion similar to that of the *Maffezini* case.”<sup>109</sup> The parties elected not to include this footnote explicitly rejecting *Maffezini* in the final text, but instead agreed that the footnote should inform the interpretation of the treaty as part of the agreement’s negotiating history that expresses a shared understanding of scope of the most-favored-nation provision.<sup>110</sup>

The U.S.-Peru Trade Promotion Agreement (“TPA”), for example, contained a footnote specifying that the treatment guaranteed under the most-favored-nation provision “does not encompass dispute resolution mechanisms, such as those in section B, that are provided for in international investment treaties or trade agreement.”<sup>111</sup> The language in the TPP and the U.S.-Peru TPA is a more explicit acknowledgement of the limitations on the scope of most-favored-nation articles than that of the 2012 U.S. Model BIT, which specifies that the most-favored-nation treatment apply only “with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.”<sup>112</sup> While this language drawn from the 2012 U.S. Model BIT seems to exclude dispute settlement, arbitral tribunals could broadly interpret the ‘management’ of an investment to include dispute procedures intended to protect the investment.<sup>113</sup> The language that the negotiating states selected for the TPP thus removes any ambiguity, explicitly excluding dispute settlement from the scope of the TPP’s MFN provision.

## 2. Subsidy Schemes and Breaches of Investor Protection

TPP 9.6(5) (Minimum Standard of Treatment)	TPP 9.7(6) (Expropriation)
For greater certainty, the mere fact that a subsidy or grant has not been issued, renewed or maintained, or has been modified or reduced, by a Party,	For greater certainty, a Party’s decision not to issue, renew, or maintain a subsidy or grant, (a) in the absence of any specific

109. *Id.* at 138, note 704.

110. *Id.*

111. United-States – Peru Trade Promotion Agreement, U.S.-Peru, art. 10, note 2, April 12, 2006,

[https://ustr.gov/sites/default/files/uploads/agreements/fta/peru/asset\\_upload\\_file78\\_9547.pdf](https://ustr.gov/sites/default/files/uploads/agreements/fta/peru/asset_upload_file78_9547.pdf).

112. 2012 US Draft Model BIT, *supra* note 52, art. 4. “According to the principle of *ejusdem generis*, ‘no other rights can be claimed under a most-favoured-nation clause than those falling within the limits of the subject matter of the clause’.” Caplan & Sharpe, *supra* note 71, at 780.

113. Gilbert Gagne & Jean-Frederic Morin, *supra* note 10, at 375.

does not constitute a breach of this article, even if there is loss or damage to the covered investment as a result	commitment under law or contract to issue, renew, or maintain that subsidy or grant; or (b) in accordance with any terms or conditions attached to the issuance, renewal, or maintenance of that subsidy or grant, standing alone, does not constitute an expropriation.
---	---

The TPP also contains two provisions in both Article 9.6 (Minimum Standard of Treatment) and Article 9.7 (Expropriation and Compensation) to specify that the removal, withdrawal, or reduction in subsidies or grants does not constitute a breach of the minimum standard of treatment or an expropriation. Creating a safe harbor for changes in subsidies that governments provide is a clear response to recent arbitration cases holding governments liable for breaches of the minimum standard of treatment and expropriation when altering subsidy schemes.<sup>114</sup> Specifically, there exist a number of cases brought against European states for the retroactive rollbacks of subsidies for renewable energy in the midst of budgetary crises.<sup>115</sup> In these claims, subsidies constituted a component of the investor's reasonable investment-backed expectations, and their withdrawal then constituted a breach of the fair and equitable treatment obligation.<sup>116</sup> Liability for the restructuring of subsidy schemes can play a controlling role in state accession to investment agreements; the claims brought against Italy for reducing subsidies to photovoltaic plants following the global recession led to Italy withdrawing from the Energy Charter Treaty.<sup>117</sup> The TPP's new provisions precluding state liability for altering subsidy schemes thus further exemplify the responsive evolutionary model in investment agreements, whereby negotiating parties modify investment agreements in response to particularly expansive arbitral decisions and creative claims.

114. Bernasconi-Osterwalder, *supra* note 15.

115. Vyoma Jha, *Trends in Investor Claims over Feed-in Tariffs for Renewable Energy*, INV. TREATY NEWS: INT'L INST. FOR SUSTAINABLE DEV., (July 19, 2012), [https://www.iisd.org/itn/2012/07/19/trends-in-investor-claims-over-feed-in-tariffs-for-renewable-energy/#\\_ednref10](https://www.iisd.org/itn/2012/07/19/trends-in-investor-claims-over-feed-in-tariffs-for-renewable-energy/#_ednref10); *see also*, Rachel Thorn, *Renewable Energy Policy Changes Lead to Damages Claims*, PROJECT FIN. NEWSWIRE, (June 2014), [http://www.chadbourne.com/renewable\\_energy\\_policy\\_changes\\_june2014\\_projectfinance](http://www.chadbourne.com/renewable_energy_policy_changes_june2014_projectfinance) (noting that "[w]ind and solar companies and investors backing their projects have filed a large number of claims against the governments of Spain and the Czech Republic after the governments scaled back feed-in tariffs and other subsidies for renewable energy. Italy is also facing arbitration after making similar changes to its regulatory policies.").

116. *Id.*

117. Gaetano Iorio Fiorelli, *Italy Withdraws from Energy Charter Treaty*, GLOBAL ARB. NEWS, (May 6, 2015), <http://globalarbitrationnews.com/italy-withdraws-from-energy-charter-treaty-20150507/>.

## 3. Investment Authorization and Precluded Claims

TPP Footnote 31	WikiLeaks Footnote 30	Wikileaks Alternative Text
Without prejudice to a claimant's right to submit to arbitration other claims under this Article, a claimant may not submit to arbitration a claim under subparagraph (a)(i)(B) or subparagraph (b)(i)(B) that a Party covered by Annex 9-H has breached an investment authorization by enforcing conditions or requirements under which the investment authorization was granted.	Without prejudice to a claimant's right to submit to arbitration other claims under this Article, a claimant may not submit to arbitration a claim under subparagraph (a)(i)(B) or subparagraph (b)(i)(B) that a Party covered by Annex I-H has breached an investment authorization by enforcing conditions or requirements under which the investment authorization was granted, <i>unless such enforcement is used as a disguised means to repudiate or otherwise breach its own commitments by invalidly withdrawing the authorization.</i>	For greater certainty, a claim for breach of an investment authorization does not arise solely because a Party requires compliance with, seeks to enforce, or enforces, conditions or requirements under which the investment authorization is granted to an investor.

Creating further room for the enforcement of governmental regulations, the TPP contains a footnote not found in CAFTA-DR or previous investment agreements specifying that a claimant cannot submit to arbitration of a claim that a host state has breached “an investment authorization by enforcing conditions or requirements under which the investment authorization was granted” for the following parties: Australia, Mexico, Canada, and New Zealand.<sup>118</sup> This provision is one of the few to have changed substantively in the final months of negotiation, indicating fundamental disagreements between the negotiating parties on the number of states for which the TPP creates a safe harbor concerning the enforcement of conditions under which the host-state granted the investment authorization. The WikiLeaks investment chapter released in March of 2015 but dated January of that year contained two alternative formulations of the relevant provision, one narrower and one significantly broader than the final wording. The first formulation is identical to

---

118. TPP, *supra* note 6, art. 9.18, note 31; *Id.* at Annex 9-H.

the provision included in the final released text, except for an additional clause creating an exception to the safe harbor in the event “such enforcement [of conditions or requirements under which the investment authorization was granted] is used as a disguised means to repudiate or otherwise breach its own commitments by invalidly withdrawing the authorization.”<sup>119</sup> The second “alternative proposed working text” would be significantly broader and apply to all host states, explaining “a claim for breach of an investment authorization does not arise solely because a Party requires compliance with, seeks to enforce, or enforces, conditions or requirements under which the investment authorization is granted to an investor.”<sup>120</sup>

The provision the negotiating parties eventually placed in the TPP strikes a compromise between the two proposed working provisions. Two observations emerge from the disagreement between negotiating parties expressed in the contrasting working texts. First, given the breadth of protection the second alternative proposed working text affords any host-state party, the final wording is a significant victory for the protection of investors and investments. While the second wording would permit potentially arbitrary and discriminatory enforcement of conditions under which any host state granted investment authorization, the final text creates a safe harbor only for enforcement of conditions under a specific piece of domestic legislation in each of the four states enumerated in Annex 9-H. Second, of the four states authorizing investments at the pre-establishment phase, only Mexico qualifies as a traditional capital-importing state. Australia’s presence, however, is consistent with its broader rejection of the investor-state arbitration mechanism, including its attempt to avoid the investor-state arbitration mechanism altogether in the leaked working draft of the TPP’s investment chapter.<sup>121</sup> Nonetheless, this provision provides four states with a mechanism to control foreign investment in the sectors governed by those states’ foreign investment legislation with far more room for government regulation.

#### 4. Counterclaims

TPP 9.18(2)	<p>When the claimant submits a claim pursuant to paragraph 1(a)(i)(B), 1(a)(i)(C), 1(b)(i)(B) or 1(b)(i)(C), the respondent may make a counterclaim in connection with the factual and legal basis of the claim or rely on a claim for the purpose of a set off against the claimant. [32]</p> <p>[Footnote 32: In the case of investment authorizations, this paragraph shall apply only to the extent that the investment authorization, including instruments executed after the date the</p>
-------------	--

119. WikiLeaks Investment Chapter, *supra* note 6, at note 30.

120. *Id.*

121. *Id.*

	authorization was granted, creates rights and obligations for the disputing parties.]
--	---

For the first time in a U.S.-negotiated investment agreement, there exists a provision in the TPP that explicitly permits a respondent state to bring a counterclaim against the investor before the same tribunal evaluating the investor's claims. The draft 2012 U.S. Model BIT does not include provisions allowing states to make counterclaims against investors, indicating either an evolution in the United States' negotiating position over the past three years, or, more likely, the United States viewing counterclaims as a necessary concession to other negotiating parties.<sup>122</sup> Previously, counterclaims had been extremely rare in investor-state arbitration.<sup>123</sup> While the ICSID Convention expressly provides for counterclaims in Article 46, respondent states have encountered difficulty when tribunals assess whether or not investors have granted consent to the adjudication of counterclaims under a particular investment agreement.<sup>124</sup>

Despite this hesitancy, investor-state arbitration tribunals began to seriously consider counterclaims with the ICSID award in *Roussalis v. Romania*.<sup>125</sup> While the majority declined jurisdiction over the Respondent state's counterclaims, Arbitrator Reisman dissented, forcefully arguing that an international tribunal's adjudication of counterclaims is not only more efficient, but also beneficial to the investor when the investor itself chooses to bring suit before the neutral arbitral tribunal to avoid the national courts to which the arbitral tribunal would send the counterclaims back to.<sup>126</sup> After the dissent in *Roussalis*, ICSID tribunals have affirmed jurisdiction over a number of counterclaims, one example being the counterclaim brought by the Republic of Burundi in the case of *Antoine Goetz and Others*.<sup>127</sup> In other post-*Roussalis* arbitrations, however, tribunals have denied jurisdiction over counterclaims, leaving the doctrinal issue unsettled and largely dependent on both the degree of connection between the counterclaims and the investor's original claims and the investment agreement under which the dispute was brought.<sup>128</sup>

---

122. 2012 US Draft Model BIT, *supra* note 52.

123. Helene Bubrowski, *Balancing IIA Arbitration Through the Use of Counterclaims*, in IMPROVING INTERNATIONAL INVESTMENT AGREEMENTS 212, 215 (Armand De Mestral & Celine Levesque, eds., 2012); *see also*, Andrea K. Bjorklund, *The Role of Counterclaims in Rebalancing Investment Law*, 17 LEWIS & CLARK L. REV. 461 (2013).

124. Michael Waibel & Jake Rylatt, *Counterclaims in International Law*, U. CAMBRIDGE FAC. L. LEGAL STUD. RES. PAPER SERIES 9-12 (December 2014).

125. Spyridon Roussalis v. Romania, ICSID Case No. ARB/06/1, Award, (Dec. 7, 2011).

126. *Id.* (Reisman dissenting) ("Aside from duplication and inefficiency, the sorts of transaction costs which counter-claim and set-off procedures work to avoid, it is an ironic, if not absurd, outcome, at odds, in my view, with the objectives of international investment law.").

127. Waibel and Rylatt, *supra* note 127, at 12.

128. *Id.* at 13-14; *see also*, Anne K. Hoffmann, *Counterclaims in Investment Arbitration*, 28 ICSID REV. 438 (2013); Andrea K. Bjorklund, *supra* note 126.

By explicitly granting jurisdiction over counterclaims to arbitral tribunals, the parties negotiating the TPP resolved one of the fundamental challenges to respondent states bringing counterclaims. The TPP still requires the tribunal assess and determine the adequate degree of connection a counterclaim must share with the original investor's claim for the tribunal to assume jurisdiction. Nonetheless, the possibility of respondent states bringing counterclaims plays a significant role in maximizing efficiency within the international investment law system and promoting the best interests of both the investor and the state.<sup>129</sup> Indeed, commentators have noted that "overcoming the current obstacles to bringing counterclaims . . . serves the overall integrity and legitimacy of international investment law by infusing balance into the dispute settlement mechanism."<sup>130</sup>

### III.

#### CONTINUITY IN U.S.-NEGOTIATED INVESTMENT AGREEMENTS

##### A. Overview

Despite a number of changes from previous U.S. investment agreements that the negotiating parties intended to limit the protections afforded to investors under the TPP, the TPP's investment chapter is perhaps most notable for what has remained constant from NAFTA, to DR-CAFTA, and to almost all U.S.-negotiated BITs in the 2000s. At various points in time, in particular following the decision in U.S.-Australian FTA not to include an investor-state arbitration mechanism, commentators have considered investor-state arbitration a dying institution.<sup>131</sup> Other skeptics have noted that the watering-down of provisions protecting investors may itself be an inadequate response to a theoretically broader crisis in arbitration.<sup>132</sup>

Despite these concerns about the durability of investor-state arbitration, the TPP maintains and significantly expands the geographic reach of the investor-

---

129. See, *supra* note 118, dissent of Michael Reisman.

130. Bubrowski, *supra* note 126, at 229.

131. See, e.g., Capling & Nossal, *supra* note 6, at 3. (concluding "that because the abandonment of NAFTA-style Chapter 11 mechanisms in the Australian agreement will effectively preclude the inclusion of such provisions in future trade agreements between developed countries, the blowback we observe in the Australian case has wider and longer-term implications.") But see, Gilbert Gagne & Jean-Frederic Morin, *supra* note 10, at 382 (arguing that "even if some substantive provisions may be further scaled back and more procedural safeguards be added, there is no evidence that the United States will do away with investor-state dispute settlement or even that it will accept that such provisions be significantly curtailed.").

132. See, M. Sornarajah, *The Descent into Normlessness*, in *EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION* 631, 656 (Chester Brown & Kate Miles, eds., 2012) (arguing "[t]he third and most damaging of the developments is that defences have come to be expressly introduced into the treaties making the treaty instrument unstable and inherently worthless to the investor . . . the foreign investors themselves will see little value in such an uncertain system. It is clear that a change has to come about which will significantly undermine the existing system.").

state arbitration regime.<sup>133</sup> At a time when some critics claim international investment arbitration is descending into ‘normlessness,’<sup>134</sup> it is vital to the durability of the institution of investor-state arbitration that the TPP not only affirms the efficacy of the existing international investment arbitration regime but also significantly expands its scope in two fundamental ways. First, the TPP generally raises the floor for rights and remedies states must provide investors in the already existing investment agreements signed by the states negotiating and ratifying the TPP. Even if the protections afforded investors under the TPP are slightly narrower than those provided in previous U.S.-negotiated investment regimes, they are generally more expansive than those existing investment treaties negotiated between many of the TPP’s parties.<sup>135</sup> Second, in its unprecedented scope, the TPP serves as a vehicle for the entrenchment of the United States-led international investment regime as the global model.<sup>136</sup> When the other states party to the TPP—cumulatively forty percent of the global economy<sup>137</sup>—negotiate future investment agreements, the TPP is likely to serve as the foundation and model agreement.<sup>138</sup>

Even the method by which the negotiating parties attempted to create a more host-state friendly agreement was one of responsive and incremental change, further demonstrating the stability of the existing international investment regime. While a number of states have written a general clause creating exceptions for government regulations applicable to the entire treaty,<sup>139</sup> the TPP’s investment chapter instead stakes out the narrow exceptions—most commonly framed only as interpretive assistance—addressed above. Nonetheless, the TPP does not include a general regulatory exception, illustrating the reactive model of evolution in international investment law that the negotiating parties employed, and the extent to which the negotiating parties maintained the underlying substantive investor protections while clarifying their application.

---

133. Loukas Mistelis, *ISDS in TPP and TTIP Negotiations – Lessons for the EU*, EUROPEAN FEDERATION FOR INVESTMENT LAW AND ARBITRATION BLOG, (Nov. 10, 2015), <http://efilablog.org/2015/11/10/isds-in-tpp-and-ttip-negotiations-lessons-for-the-eu/> (arguing “[t]he key conclusion to draw from the ISDS provisions in TPP is undoubtedly a strong and unequivocal endorsement of the current practice of private arbitration of investment disputes (traditional ISDS) where the focus has moved to substantive protection rules rather than arbitration as a method.”).

134. M. Sornarajah, *supra* note 135, at 641 (arguing “all is not well with investment arbitration. It is necessary to ask what led to his present position where there is neither ‘evolution’ nor ‘revolution’ . . . but a descent into the morass of ‘normlessness’.”).

135. Chaisse, *supra* note 18, at 134.

136. *Id.* at 104-5 (arguing the TPP “implies that the US-inspired investment rule-making is about to achieve global status.”).

137. FERGUSSON, MCMINIMY, WILLIAMS, *supra* note 3.

138. Chaisse, *supra* note 18, at 104-5.

139. TITI, *supra* note 111, at 173-4 (noting that the general exception clause exists in Canada’s Model BIT and an increasing number of free trade agreements, including the Energy Charter Treaty, the Australia-Singapore FTA, the ASEAN CIA, the ASEAN-Korea FTA, the ASEAN-China Investment Agreement and, the CETA).



### B. Expanded Investor Protections

Additionally, the parties negotiating the TPP provide new rights for investors not found in previous investment agreements that the United States ratified in at least one noteworthy way. The TPP includes the following language that is new to U.S.-negotiated investment agreements:

No party shall, in connection with the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment of an investor of a Party or of a non-Party in its territory, impose or enforce any requirement, or enforce any commitment or undertaking . . . .

(f) to transfer a particular technology, a production process or other proprietary knowledge to a person in its territory . . . .

(h) (i) to purchase, use or accord a preference to, in its territory, technology of the Party or of a person of the Party [footnote 24: For the purposes of this Article, the term “technology of the Party or of a person of the Party” includes technology that is owned by the Party or a person of the Party, and technology for which the Party or a person of the Party holds, an exclusive license.]; or (ii) that prevents the purchase or use of, or the according of a preference to, in its territory, a particular technology . . . .<sup>140</sup>

This prohibition against discriminatory indigenous technology requirements originated with the 2012 U.S. Model BIT.<sup>141</sup> The TPP’s language relies heavily upon Article 8(1)(h) of the 2012 Model BIT, which prohibits both requirements to purchase, use, or accord a preference to local technologies and requirements that prevent the purchase of a particular technology.<sup>142</sup> Commentators have noted that this requirement expands the usual performance requirements provision found in existing U.S. investment agreements so as to prohibit a host state from preferring local technology throughout the lifespan of the investment.<sup>143</sup> The host state, however, retains the authority to require particular technologies, provided they serve a legitimate and non-discriminatory purpose, further illustrating the extent to which the parties negotiating the TPP sought to emphasize a host state’s capacity for regulation.<sup>144</sup>

### CONCLUSION

Through the modifications discussed in Section II, the final investment chapter in the TPP addresses many of the most significant criticisms of investor-state arbitration raised during the negotiations. Whether resolving claims that U.S.-negotiated trade agreements grant investors protections that exceed those afforded to domestic, American investors<sup>145</sup> or including a number of new provisions to strengthen the basis upon which a state can regulate without fear of

140. TPP, *supra* note 6, art. 9.9(1)(f), art. 9.9(1)(h)(i)-(ii).

141. 2012 US Draft Model BIT, *supra* note 52, art. 8.1(f).

142. Caplan & Sharpe, *supra* note 71, at 799.

143. Chaisse, *supra* note 18, at 126.

144. Caplan & Sharpe, *supra* note 71, at 800.

145. See *supra* § II.A.5.

incurring liability for the losses of foreign investors,<sup>146</sup> the TPP strengthens the position of respondent states relative to previous U.S.-negotiated investment agreements. The negotiating parties employ the vast majority of these modifications to respond to previous investment tribunals' decisions—or even unsuccessful claims brought by investors—that undermined the domestic political legitimacy of investor-state arbitration, while maintaining the foundational architecture of the existing international investment regime: national treatment, most-favored nation treatment, minimum standard of treatment, and the prohibition on uncompensated expropriation.

Indeed, it remains to be seen whether such modifications to the guarantees host states must provide investors will prove to substantively alter the resolution of investor claims brought against parties to the TPP. Because the TPP's MFN clause is characteristic of most U.S.-negotiated FTAs and BITs in its complete coverage of substantive rights, it is very possible that claims brought under the TPP will primarily seek to apply the substantive provisions of a host state's existing investment agreements.<sup>147</sup> The TPP's most significant legacy in the area of investment arbitration may simply be the linking and geographical expansion of existing investment protections through the TPP's MFN provision that requires the equivalence of substantive protections for foreign investors across all of a host-state's investment agreements.<sup>148</sup> If the treatment states must provide investors is even slightly more favorable for investors in previous investment agreements than in the TPP, the TPP may primarily constitute an extension of the most favorable provisions in any given host state's inventory of existing investment agreements for the investors of parties to the TPP.<sup>149</sup>

This possibility does not, however, imply that the provisions added to the TPP will have little effect on the resolution of investor-state disputes; rather, the possibility for incorporation of substantive protections in parties' existing investment agreements through the TPP's MFN provision offers a compelling explanation for the method the TPP parties employed in introducing changes from previous agreements to the TPP. By presenting many of the modifications

---

146. *See supra* § II.

147. Chaisse, *supra* note 18, at 135 (explaining “[t]he TPP MFN expressly extends the coverage of the MFN obligation to pre-establishment rights.”).

148. For a summary of the existing international investment agreements that the parties negotiating the TPP have ratified, see Chaisse, *supra* note 18, at 129-34.

149. For more on this broad effect of the MFN provision on international investment law, see STEPHAN W. SCHILL, *THE MULTILATERALIZATION OF INTERNATIONAL INVESTMENT LAW* 366 (Cambridge University Press, 2009). (concluding that, assuming the existence of an investment agreement, “MFN clauses, therefore, create a uniform regime for the protection of foreign investors in any given host State independent of the investor’s nationality.”). Also worth noting is the open nature of the TPP; the TPP permits any new member to sign up without regard for geographic or economic conditions so long as the current TPP member states elect to accept the prospective member. With a number of prospective member states already expressing interest in ratifying the agreement, there exists the potential for the TPP’s investment chapter to form in effect a multilateral agreement on investment protection, providing the vehicle through which the MFN clauses of a party state’s existing investment agreements are disseminated.

as interpretative guidance or clarifications, the negotiating parties frame a modification as merely the most recent expression of established understanding in international investment law. The TPP thus seeks both to extend the existing U.S.-negotiated international investment regime and to clarify the provisions that investment regime guarantees in a manner that expands a state party's ability to regulate for the public welfare.